S. HRG. 98-1013

TENDER OFFER PRACTICES AND CORPORATE DIRECTOR RESPONSIBILITIES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

THE CONDUCT OF CORPORATE OFFICIALS, THE EFFECTIVENESS OF STATE LAWS ON TENDER OFFERS AND CORPORATE RESPONSIBILITY, AND THE ROLE OF FEDERAL SECURITIES LAWS

S. 2448

To amend the Securities Exchange Act of 1934 with respect to tender offers.

S. 2797

To require that directors of certain corporations hold securities of those corporations.

OCTOBER 2, 1984

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

39-663 O WASHINGTON : 1984

S241-2.

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TENDER OFFER PRACTICES AND CORPORATE DIRECTOR RESPONSIBILITIES

TUESDAY, OCTOBER 2, 1984

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Banking Committee met at 2:05 p.m., in room SD–538, of the Dirksen Senate Office Building, Senator Alfonse M. D'Amato presiding.

Present: Senators D'Amato, Riegle, Dodd, and Lautenberg.

OPENING REMARKS OF SENATOR D'AMATO

Senator D'AMATO. The committee will come to order. Senator Garn, the chairman of the committee, has asked me to chair this hearing today and he has submitted a statement which I would like to insert in the record at this point.

[The following was received for the record:]

STATEMENT OF CHAIRMAN GARN

Senator GARN. The committee meets today to discuss certain tender offer and corporate governance issues raised on the Senate floor during the consideration of S. 2851, the Financial Services Competitive Equity Act. Senator Metzenbaum had proposed amendments to S. 2851 to eliminate two-tier tender offers by prohibiting the purchase of more than 20 percent of a company's stock without an identical offer to all shareholders and to increase the minimum time period of a tender offer from 20 to 60 days. Senator Chafee had proposed amendments to require that a director of a public company own at least 1,000 shares of that company and to establish a Federal business judgment rule by allowing shareholders and the Securities and Exchange Commission to seek injunctive relief from harmful defensive tactics by management in corporate takeover situations. During the floor discussion of these amendments, it was agreed that the proposed amendments would not be pursued at that time and that the committee would conduct a hearing on these matters before Congress adjourned.

Thus, the committee is appreciative of the efforts of Senators Chafee, Metzenbaum, and Specter, who have introduced legislation on these issues, and of Chairman Shad, Mr. Pickens, Mr. Klein, and Mr. Howell in agreeing to participate in this hearing on such short notice.

Until the enactment of the Williams Act in 1968, the securities laws did not contain a detailed framework for the regulation of cor-

porate takeovers in the national securities marketplace. The Wiliams Act was designed to establish disclosure and procedural requirements to be followed in tender offers and to maintain the neutrality of such requirements. The concern over neutrality is evident from the following excerpt from the Senate Banking Committee's report on the tender offer legislation:

> The committee has taken extreme care to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case.

This hearing will focus on issues which have become increasingly important as our Nation's economy continues to evolve. Tender offers and corporate takeovers were the subject of a letter from members of this committee to the SEC in February 1983 and of the SEC's Advisory Committee on Tender Offers which issued its report in July 1983.

The issues we will discuss today are clearly not easy to resolve. They affect not only disclosure standards but also raise questions about the conduct of corporate officials, the effectiveness of State laws on tender offers and corporate responsibility, and the role of the Federal securities laws. I have felt that the neutrality of the securities laws in the tender offer area is the appropriate path for the Federal Government to take. That is, require full disclosure and allow shareholders to determine whether to buy, sell, or maintain their investment.

In certain situations, it may be appropriate to revise the existing standards to ensure that they provide adequate notice and information to shareholders. This hearing provides the committee with an excellent opportunity to consider the extent of problems under existing securities statutes and the possible need to make statutory revisions.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Our first witness will be Senator John Chafee, who has been instrumental in bringing to the forefront certain issues in corporate activities. I want to thank Senator Garn and the Banking Committee staff for expeditiously arranging these hearings to consider certain legislative proposals surrounding the tender offer area.

This is a busy time of year, so I will not make a lengthy statement. However, I would like to make some brief observations before we turn to our distinguished witnesses.

Corporate takeovers are now a very high profile issue. They involve at times billions of dollars. Some contend that the extraordinary amount of debt incurred by acquirers in a tender offer has a harmful effect on interest rates. Others disagree and claim that funds expended in tender offers are immediately funneled back into the market. Corporate takeovers also have antitrust implications, labor ramifications, and an impact on stockholders rights and cause a State versus Federal regulatory turf battle at times.

When the concerns of labor, management, stockholders, and Government are coupled with multibillion dollar transactions, the

losers in a takeover will demand congressional action and the winners will fight any proposed policy changes.

I am concerned about many of the tactics used by both targets and raiders in a takeover battle. Many of these tactics have developed catch phrases that would make the CIA proud. For the targets, "greenmail," "golden parachutes," "poison pills," and "selling off the crown jewels," have been used to thwart takeovers. Corporate raiders have employed such tactics as the two-tier front end loaded tender offer.

Try tc figure that out.

Sneak attack through a so-called "creeping tender offer" and all the cash, junk bond, bust-up takeover. The nomenclature alone is enough to perk this Senator's interest. Many of these tactics are not in the best interests of stockholders or employees. However, a knee-jerk response by the Congress may exacerbate the problem. If Congress eliminates certain alleged abuses, such as poison pills, this might force targets to employ a scorched earth policy. This is in the worst interest of a target's shareholders. The House Energy and Commerce Committee has done a good job in highlighting many of the problems that exist in corporate takeover battles. They have begun the process of review of tender offers.

Quite frankly, though I feel my friend on the committee may have had a knee-jerk response to tender offers with very little study—only two hearings were held and markup of H.R. 5693 had no debate—I share the committee's concerns, but I fear the inadvertent result of H.R. 5693, which may not be in the best interest of all of those who are concerned. For instance, I feel that the legislation in many ways would hinder acquirers by mandating community impact statements and by limiting poison pill issuances. But if an unfriendly takeover were made, the target would be forced to use tactics such as the scorched earth policy or selling the crown jewels.

This is because H.R. 5693 limits certain abusive tactics and not others. In effect, the legislation encourages the worse kind of defensive tactics, if a hostile takeover were pursued.

As chairman of the Securities Subcommittee, I intend to conduct hearings on the adequacy of the Williams Act. Furthermore, I will seek to determine whether the Federal Government should supersede State activities in regulating tender offers. We may find that a national tender offer policy is needed. If so, I will not shy away from formulating such a national policy on corporate takeovers that would eliminate the irresponsible activities of targets and raiders. However, my goal will not be to eliminate takeovers which pay shareholders a premium for their shares.

I thank our panelists for coming, and I want to commend Senator Chafee for requesting this hearing so that he could bring to the committee's attention some very important legislative proposals. Senator Chafee.

[A glossary presenting short definitions of a selection of terms associated with mergers and acquisitions can be found on p. 135.]

STATEMENT OF JOHN H. CHAFEE, U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Senator CHAFEE. Mr. Chairman, I want to thank you and Senator Garn both very much for scheduling these hearings so quickly.

As you mentioned, this stemmed from the introductions that I made to the banking bill, S. 2851 and some amendments dealing with corrections to management abuses. And at that time, you indicated that you would hold these hearings rapidly and you certainly have lived up to your commitment, and I appreciate it.

A barrage of takeovers is blasting its way through the corridors of corporate America.

The frenetic pace of corporate takeovers this year is setting new dollar volume records for mergers and acquisitions, with $18 billion deals announced or completed already.

Now, unquestionably, there are positive sides to all this activity in the merger market; many companies can shed unwanted and unprofitable pieces of their business to concentrate on what they do best.

The economic rewards of this flurry of merger activity can be great for some: Raiders benefiting from the practice of greenmail, investment bankers who put together these merger deals. Enormous sums of money are certainly being exchanged.

Yet little attention is given to the rights and interests of most shareholders who must wait until the dust settles to determine just how their investment has been affected. Little attention is given to the workers whose jobs are threatened by these activities.

Take greenmail, for example. Most public and congressional concern has focused on the tactics used by corporate raiders to gain control. In the heat of a takeover contest, as the offensive and defensive battle escalates, important shareholder, employee, and community interests are frequently overlooked.

Defense tactics with exotic names, some of which you have mentioned, such as the poison pill and scorched earth defense, reflect the corporate gamesmanship involved in attempts of management to thwart hostile takeovers through actions that may, at the same time, damage their own company.

Is it fair that corporate management has virtually unlimited discretion to use or sell corporate assets to defend against a takeover? In the case of a hostile takeover, it is clear that management's interest in perpetuating its control may conflict with the interest of the shareholders, the employees, and the future of the company.

In theory, a major responsibility of a corporation's board of directors is to monitor carefully corporate policy in order to prevent abuses of this kind. In an ideal world the board of directors is elected by the corporate shareholders to represent and protect their interests. The board should act as a watchdog over management with a fundamental concern for long-term corporate survival as a basic protection for the stockholders investment. But in fact—and I think we all know this—corporate boards frequently do not exercise meaningful oversight and control over management.

The expectation that the board of directors, as the shareholders' surrogate, will act as the watchdogs of management, must be enforced by legislation and regulation. Many directors are part of a clubby atmosphere that tempts them to rubberstamp management

decisions with few questions. As captives of management these directors can hardly be expected to initiate voluntary reforms.

Nearly every director is picked by the invitation of the top management of the corporation. The chief executive of the corporation goes around and says to Mr. So-and-So or Ms. So-and-So, "We'd like you very much to be on our board of directors," and that potential director knows whereof he or she received this plum and is forever grateful and acts that way.

I submit that this surrogate role would come more easily to a director who is himself a shareholder concerned about the future of the company as an owner ought to be. In a company where the founder or majority stockowner is chairman of the board, you will find that kind of objectivity and scrutiny. Directors do not hesitate to ask all sorts of questions of managers running the company, when these directors are also the major investors in the corporation. You can be certain they won't be satisfied if performance does not come up to expectations.

By having a direct financial stake in the company, directors would start to think more like shareholders and less like management. The legislation which I propose would require that each director of a public corporation, the common stock of which is registered with the SEC, purchase at least 1,000 shares of that stock before collecting any director's fees. Until 1,000 shares are acquired, the director's fees can go toward the purchase of those shares of stock.

Now Mr. Chairman, I am not in concrete on whether it's 1,000 or 750 or whether it should be a corporation that is solely traded on the big board or on the American exchange. But the point I'm trying to get across is that those men and women on the board of directors, who make the major decisions, ought to have a stake in the corporation. And we all know as we look down lists and proxy statements that in many instances their holdings are infinitesimal; not as regards a percentage of the total, but just as the number of shares held.

Let me add that in introducing this amendment, I do not intend for this requirement to apply where it would simply be a nuisance. Say, for example, small companies with unusual capital structures or shares not actively traded on the major exchanges. Congress cannot legislate the independence of corporate boards, but we can attempt to instill an increased measure of responsibility in their behavior.

My second proposal would give shareholders and the SEC the right to seek injunctive relief in Federal district courts against harmful actions by management in connection with a takeover attempt or change of control. Management would have the burden of proving the prudence and fairness of its actions.

This proposal questions the business judgment rule. This rule generally provides that courts, that is, State courts, will not interfere with corporate decisions if they can be attributed to a rational business purpose, so long as these decisions do not involve gross and palpable overreaching.

I submit, however, that this business judgment rule is inappropriate in the context of hostile takeovers or other situations involving a threatened change of control in a corporation. I believe that the soundness of management's judgment fades as its position and status are threatened; its decisions under those circumstances are

solely or frequently self-serving. As the takeover battle escalates, challenged incumbents have not hesitated to pursue actions that weaken their corporation solely to preserve their management positions, and I don't think we have to look very far for examples of that.

Stockholders watch helplessly while wheeling and dealing executives treat huge corporations as private playpens. Two years ago, for example, the managers of Martin Marietta effectively committed the company to self-destruction as a means of fending off a takeover bid by Bendix.

The business judgment rule allows management and directors wide latitude to devise strategies to resist unfriendly advances. The rule in my estimation should govern only where management and directors are not shown to have a self-interest in the transaction at issue. Once self-dealing or bad faith is demonstrated, then management and directors should be required in court to prove that the transaction was prudent and reasonable to the corporation, and fair to the shareholders.

My proposals, which I introduced as amendments to the Senate banking bill S. 2851, are efforts to prevent the increasing management abuses that have been so troubling, and thus protect shareholders. At the same time I believe that more responsible corporate behavior will help protect workers and their jobs, and by encouraging wiser management, stimulate the creation of new jobs.

Thank you very much for this opportunity, Mr. Chairman.

Senator D'AMATO. Thank you, Senator Chafee. We'll hear from Senator Specter and then we'll have Chairman Shad and another group of witnesses, and you will both be invited to join us.

Senator Specter.

STATEMENT OF ARLEN SPECTER, U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator SPECTER. Thank you very much, Mr. Chairman. I appreciate this opportunity to testify before the Subcommittee on Securities, and I commend you, Mr. Chairman, for convening this hearing.

The proposal that I urge the subcommittee to report favorably on is S. 2448, which would prohibit anyone from acquiring more than 20 percent of a corporation's stock via tender offer unless an offer is made for all outstanding shares.

And I would like to modify that, Mr. Chairman, to make that apply to acquisition of stock by any means, the suggestion made by Mr. Shad, although the SEC is taking no position on S. 2448, as I understand it.

This bill is proposed because of the circumstances which very seriously affected two Pennsylvania corporations as well as many corporations across the country, and I refer specifically to Gulf and to Quaker State.

The Judiciary Committee held a series of hearings at a time when there was consideration of a 6-month moratorium, and our hearings before the judiciary disclosed a great many problems which ought to be addressed. I voted against the 6-month moratorium because of my concern for influencing market factors in that means, but I am hopeful, Mr. Chairman, that early in the 99th

Congress we will address the very serious problems which have been posed by events of the immediate past.

In my judgment the form of the securities laws regulating tender offers is crucial to the protection of millions of American shareholders. Over the past 4 years, the increasing use of blitzkreig takeover tactics has made it difficult to ensure the small shareholders are fairly treated.

In the frenzied world of takeover warfare, even hotly opposed acquisitions can be completed before shareholders have an opportunity to make an educated and informed response, and after-the-fact remedies unfortunately are inadequate or nonexistent.

This year is on its way to setting a dollar volume record for merger and acquisition deals, with a total value of publicly announced mergers for the first 5 months of this year approaching $60 billion; 1984 might also set a record for the number of mergers in 1 year. During the first quarter 710 mergers were announced, almost one-third more than for the comparable period of 1983; and this number is well on its way to breaking the record of 2,861 mergers in 1974.

As a Senator from Pennsylvania, the merging of Gulf Oil Corp. with Standard Oil of California brought into sharp focus the harm which can result from hostile takeovers, and that harm is as yet not fully recovered, but Pennsylvania may be the loser with a loss of corporate headquarters in Pittsburgh and substantial operations in the Philadelphia area.

At the time of the Gulf-SoCal merger there was considerable support for imposing an across-the-board merger moratorium, and as I commented before I voted against that because of the influence on market circumstances and believe that other measures were preferable and that S. 2448, in my judgment, offers a first step in this regard.

This legislation proposes to amend the Securities Exchange Act of 1934 to provide that it shall be unlawful for any person to make an offer for more than 20 percent of an equity class of a company's stock unless such person is the issuer of the security or the offer is a cash offer for all of the outstanding shares of the equity class.

This bill tracks the recommendation made in 1983 by the Securities and Exchange Advisory Committee on Tender Offers. That committee, composed of investment bankers, academics, lawyers, accountants, recognized that often all shareholders do not share equally in the total merger price. The first shareholders sell their stock often to larger institutionalized professional investors and receive a premium for control of the corporation, while the remaining smaller shareholders receive less.

And, as detailed in my statement, Mr. Chairman, which I would like to submit for the record, the statistics on the Gulf-Mesa arrangement demonstrates that my bill would also prevent so-called creeping acquisitions. If an investor slowly buys up the stock of a corporation, he can gain control of the corporation without paying the control premium. The acquirer gets an asset he does not pay for, and the old shareholders have sold their stock for less than its true value.

S. 2448 is designed to prevent this by requiring the purchaser to pay the full price of the assets he receives.

Equally important, S. 2448 also addresses the abusive practice of greenmail, and as set forth in the full statement, which I ask be made a part of the record, Mr. Chairman, there is a detailing of the profits made in greenmail operation, to Walt Disney almost $60 million; Quaker State in Pennsylvania, which cost $10.7 million; Texaco, $280 million; and other specific unfair profits made in this procedure.

These investors are extorting money from target corporations and making large profits without providing any consideration for the moneys they receive. The ultimate losers are the other shareholders of the targeted company.

Mr. Chairman, that is the essence of some of the reasons that I have introduced S. 2448 as well as companion legislation.

I ask that the full statement be made a part of the record, and I do urge that this subcommittee and the full committee take a look at these issues early on in the 99th Congress so we do not confront the situation which we had during the 98th Congress when the 6-month moratorium came within a fraction of passing.

It was only the assurance of Senator Dole for a comprehensive reevaluation, some of the comments from Senator McClure—very cogent comments about affecting the market situation—I think what stemmed the tide at that time, and absent some serious remedial legislation, I believe we are going to confront this problem again, perhaps in a more chaotic climate, which may lead us to acting in a way where it would be preferable if we could act with more thought and more consideration as this proceeding is endeavoring to do.

I thank the Chair.

COMPLETE PREPARED STATEMENT OF SENATOR ARLEN SPECTER

I appreciate this opportunity to testify before the Subcommittee on Securities and I commend you, Mr. Chairman, for convening this hearing.

Reform of the securities laws regulating tender offers is crucial to the protection of millions of American shareholders. Over the past 4 years, the increasing use of blitzkreig takover tactics has made it difficult to ensure these small shareholders are fairly treated. In the frenzied world of takeover warfare, even hotly opposed acquisitions can be completed before shareholders have an opportunity to make an educated and informed response, and, "after the fact" remedies may be inadequate or nonexistent.

This year is on its way to setting a dollar volume record for merger and acquisition deals with the total value of publicly announced mergers for the first 5 months of this year approaching $60 billion. In fact, 1984 may also set a record for the number of mergers in 1 year; in the first quarter of the year, 710 mergers were announced, almost one-third more than for the comparible period of 1983, and this number is well on its way to breaking the 1974 record of 2,861 mergers.

As a Senator from Pennsylvania, the merger of Gulf Oil Corp. with Standard Oil of California [SoCal] brought into sharp focus the harm which can result from hostile takeovers. In that case, the attempt by Mr. Boone Pickens and Mesa Petroleum to gain control of Gulf, forced Gulf into the arms of SoCal. As a result, Pittsburgh is in jeopardy of losing a valuable corporate constituent which employs hundreds of Pennsylvanians.

At the time of the Gulf-SoCal merger, there was considerable support for imposing an across-the-board merger moratorium. I voted against such a moratorium because, as I stated at that time, I believed the better course would be to enact legislation tailored to eliminate abusive or harmful takeovers. I believe S. 2448 offers an important first step in this regard.

This legislation amends the Security Exchange Act of 1934 to provide that it shall be unlawful for any person to make an offer for more than 20 percent of an equity class of a company's stock unless such person is the issuer of the security or the

offer is a cash offer for all of the outstanding shares of the equity class. This tracks a recommendation made June 10, 1983, by the Securities and Exchange Advisory Committee on Tender Offers.

That committee, composed of investment bankers, academics, lawyers, and accountants, recognized that often all shareholders do not share equally in a total merger purchase price. The first shareholders to sell their stock, often the larger institutionalized professional investors, receive a premium for control of the corporation while the remaining smaller shareholders receive less.

The case of the Mesa bid for Gulf demonstrates the disparate prices shareholders currently receive for their stock. Gulf believed Mesa threatened to take control when it purchased 13.2 percent of Gulf and announced plans to purchase another 8.2 percent. Mesa paid an average of $44 per share for the first 13.2 percent and would have paid $65 a share for the next 8.2 percent. SoCal offered $80 per share for all the shares. By limiting any minority investment to 20 percent, S. 2448 will insure that all shareholders share equally in the "control premium" when a merger occurs.

The bill will also prevent "creeping" acquisitions. If an investor slowly buys up the stock of a corporation, he can gain control of the corporation without paying for the control premium; the acquirer gets an asset he did not pay for and the old shareholders have sold their stock for less than its true value. S. 2488 prevents this and requires the purchaser to pay full price for the assets he receives.

Equally important, S. 2448 also addresses the abusive practice of "greenmail." Currently, investors may purchase a substantial but minority share of a corporation's stock. To prevent such a substantial investor from acquiring control, a target corporation frequently buys back the investor's share at a premium over the existing market price.

The first 6 months of 1984 have produced greenmail profits in excess of $600 million. The largest transaction involved a $280 million profit made in March by the billionaire Bass brothers of Houston when Texaco, Inc., bought back the 9.9-percent stake in Texas the Bass brothers had accumulated. The following chart, printed in the July 3 New York Times listing large greenmail transactions during this period, further demonstrates the staggering profits being turned:

[Dollars in millions]

Investor	Stake repurchased	Repurchase price	Premium over market value of stock (percent)	Estimated profits
Saul Steinberg	11.1 percent of Walt Disney	$325.5	19	$59.6
Saul Steinberg	8.9 percent of Quaker State	47.1	28	10.7
Bass Brothers	9.9 percent of Texaco	1,280.0	12	280.0
Charles E. Harwitz	11.8 percent of Castled Cooke	70.5	25	13.9
Rupert Murdock	8.6 percent of Warner Communications	181.6	42	49.8
Sir James Goldsmith	8.6 percent of St. Regis	160.0	30	51.2
Costal Corp	5.0 percent of Houston Natural Gas	139.5	26	42.1

Sources: John C. Boland and Kidder, Peabody & Co.

These "investors" are extorting money from target corporations, and making large profits without providing any consideration for the money they receive. The ultimate losers, of course, are all of the other shareholders of the target company. The premium paid to the greenmailers reduces the assets of the corporation and causes the market price of the stock to drop. For example, after Walt Disney, Inc., repurchased its stock from Saul Steinberg, the market price of the stock fell by more than $10.

S. 2448 will curb greenmailers' extortion by diminishing the greenmailers' ability to intimidate corporate directors. Unless a purchaser is interested in acquiring all corporate assets his investment share will be statutorily limited.

The 20-percent ownership level recommended by the SEC and included in S. 2448 can be adjusted if necessary. The object is to establish a threshold that will permit corporate affiliations where control is not an issue and will permit important minority investments when valid business reasons exist for such an investment.

I would also like to point out that S. 2448 contains language which would provide that the Commission shall, by rules and regulations, provide for exemptions from

this prohibition where it finds that such exemptions are not inconsistent with the public interest or protection of investors. For example, where a family group owns a block of stock, a father should be able to sell or bequeath his stock to his son without his son's being required to make a tender offer for all of the company's stock.

If this reform to the securities laws is implemented, I am confident that merger activity which discriminates against the small shareholders and subjects all corporations to extortionate demands from greenmailers may be foreclosed.

Senator D'AMATO. I want to thank the distinguished Senator from Pennsylvania, Senator Specter, who does raise a number of important issues.

We have, as you know, passed in the banking bill, provisions dealing with some of the abuses in tender offers. Senator Riegle and I offered amendments to eliminate greenmail and golden parachutes. So we are beginning to make progress.

I would like to hear what Commissioner Shad has to say with respect to these amendments in the banking bill as well as the proposal offered by Senator Chafee. I see Senator Metzenbaum has joined us.

Senator Metzenbaum.

STATEMENT OF HOWARD METZENBAUM, U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. Thank you, Mr. Chairman. I sort of feel that this is my day to spend time with you, having spent most of the morning with you on a totally different subject.

I am very grateful to you for holding this hearing. As you well know, in connection with the banking bill, I was prepared to offer amendments having to do with the two-tier offers, as well as extending the offer period from 20 to 60 days. I can't say to you with certainty that 60 days is right. I can say to you with some reasonable assurance that 20 days is too short a period. I think what we're really talking about is fairness and equity, and I think what we're talking about is the question of whether or not in this field of takeovers we're going to sit back and permit some people who are savvy, knowledgeable, sophisticated, and perhaps in a position of majority control to get the cream and let the unsophisticated shareholders wind up just getting ordinary milk or in some instances, skim milk.

As a matter of fact, between 1981–83, according to the SEC, first-tier offers gave shareholders on the average a 64-percent premium while second-tier offers gave shareholders an average premium of only 47 percent.

When United States Steel Corp. acquired Marathon, they paid shareholders a premium of 109 percent. The back end paid a premium of just 24 percent. The front-end takeover of St. Joe's Minerals paid shareholders 107 percent premium; the back-end shareholders got a 47-percent premium. Du Pont paid front-end tenders of Conoco a 81-percent premium while back-end tenders received only a 34-percent premium; Allegheny International offered a 93-percent premium to Sunbeam shareholders on the front end and only a 32-percent premium on the second-tier shareholders.

Now I have all sorts of quotes here. I have quotes here from Paul Elicker, chairman of SCM Corp., that "two-tier offers are inherently coercive and unfair." Hennessey of Allied Corp. to the same

effect; John Hetherington, American Society of Corporate Secretaries, suggesting a longer term period: "We favor amending section 14 of the Securities and Exchange Act to increase the time that a tender offer must remain open"; from Felix Rohatyn, that the two-tier tender offer "should be prohibited," and others as well.

But frankly, Mr. Chairman, we don't need all their testimony. We're ostensibly reasonably knowledgeable people, and if we're reasonably knowledgeable, we can understand the unfairness and the inequity, and in this Senator's opinion, the inequity of some people in a control position being paid excessive dollars to get control and letting the rest of them fall by the wayside.

And that relates as well in a similar manner to the whole issue of greenmail, which I didn't offer as an amendment because it was already in the bill. But the fact is, I don't know how anybody can come before this committee—and I will be interested to see what kinds of people come before us today to indicate that they believe that it's right for somebody to get $100 for their shares and for the rest of the crowd to get $60 or $70 for their shares. That's just so basically wrong, it's offensive to me. I came out of the corporate world before I came to the U.S. Senate. I was involved in acquisitions. I have no recollection of ever being involved in any buyout in that manner. And this is just a procedure that grew up in more recent years.

It is my understanding that it grew up because a court decided that it was an appropriate procedure—I think I'm right about this, but I'm not positive—it was an appropriate procedure if a majority of the outside directors agreed that it was appropriate. I don't buy that. First of all, outside directors are not really outside directors. No less an authority than Harold Geneen in Fortune magazine recently pointed out the fact that the directors are all beholden to the chief executive officer, and he calls the shots, that they don't have any independence, in spite of the fact that they're outside directors.

Now I just think, Senator, and members of this committee that you don't have to be sophisticated in the banking world, you don't have to come out of the corporate world; you don't have to be anything other than a fair, reasonable person to understand how bad it is, how wrong it is for some people who own a piece of a corporation, whether just 1 share or 100,000 shares, to get a premium for their stock and for the others to not get the same amount.

With respect to the time element, I think that between the time the mail gets out and it gets to the widows and it gets to the others, unless there are sophisticated people receiving those notices, they are not always in a position to act with dispatch. They lay it aside on the kitchen table, and then the 20 days have expired, and it's too late.

I think 60 days—no harm would come to the offeror—or whether you decide that it ought to be 45 days instead of 60, I wouldn't get upset about that——

Senator D'AMATO. What you're suggesting, Senator, you're saying, Senator, 20 days is inappropriate, it should be sometime——

Senator METZENBAUM. Something in excess of that.

So Mr. Chairman, I really want to say I recognize that nothing is going to happen on this subject in this session.

Senator D'AMATO. Well, the greenmail provision, Senator, as you correctly pointed out, we did have in the mail. I think there's pretty good acceptance with respect to that provision, which requires that if someone that owns 3 percent or more of the stock for less than 2 years, that offer would have to be made to everyone. You would be able to——

Senator METZENBAUM. I thank the committee for putting that in.

Senator D'AMATO. And it seems to me, and I'd like to get comments from Chairman Shad and from Mr. Pickens, when he comes up. That's a rather reasonable kind of protection to stockholders and to those who want real venture capital, et cetera, as opposed to someone who comes in to acquire and be purchased out with an inordinate sum. And by the way, I don't criticize anybody for doing that what they have done. The law permitted it.

Senator METZENBAUM. I agree with you.

Senator D'AMATO. We shouldn't criticize that.

Senator METZENBAUM. It's our job to change the law.

Senator D'AMATO. If it needs to be. And I'd like to get comments with others with respect to that. Maybe the 3-percent figure is not the right target, but that's what we came up with.

I would invite both Senators Specter and Metzenbaum to join the committee for any questions that they might have at this time.

I know that our witnesses have busy schedules. Mr. Pickens has a plane to catch. Chairman Shad is coming from New York and has a committee meeting. So why don't we continue with Chairman Shad.

Senator D'AMATO. Chairman Shad. I am wondering if you would comment on the proposals before us today with some degree of specificity.

STATEMENT OF JOHN S.R. SHAD, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Chairman SHAD. I will be very pleased to respond separately to the four proposals that have just been advanced and to take it from the top, Chairman D'Amato and members of the committee and Senators Chafee, Metzenbaum, and Specter, the SEC appreciates this opportunity to respond to the committee's request to testify on four specific proposals to amend the securities laws, and we would request that our formal statement be included in the record.

Mr. Chairman.

[The complete statement follows:]

STATEMENT OF JOHN S.R. SHAD
CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION
BEFORE THE SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS

Tuesday, October 2, 1984

Chairman Garn and Members of the Committee:

I. Introduction

The Commission appreciates this opportunity to testify on four proposals to amend the federal securities laws. Since this hearing was called on short notice, the Commission will be pleased to provide supplemental responses to questions, if any, not fully addressed in this testimony.

The four proposals under consideration are innovative approaches to important issues, but the Commission does not support these amendments at this time for the reasons set forth below.

II. Background

By way of background, the Commission established a Tender Offer Advisory Committee on February 25, 1983. The Senate Banking Committee was supportive of the creation of the Advisory Committee, requested that its report be provided

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by July 31, 1983 and raised a number of issues 1/ to which the Advisory Committee responded in its July 8, 1983 report. 2/

The Commission requested the Advisory Committee to review tender offer practices and regulations and propose specific regulatory and legislative improvements for the benefit of all shareholders (i.e. shareholders of all corporations, whether potential acquiror, target or bystander company).

The Advisory Committee's July 8, 1983 report was delivered to members of the Senate Banking Committee and the House Energy and Commerce Committee.

With the benefit of the Advisory Committee's report and the Commission's independent analysis, the Commission submitted to Congress on May 21, 1984 legislative proposals which would make the following statutory changes:

(a) reduce the 10-day filing requirement under Section 13(d) of the Securities Exchange Act of 1934 (Exchange Act);

1/ See Exhibit A (letter of February 1, 1983 to Chairman Shad from members of Senate Committee on Banking, Housing and Urban Affairs).

2/ See attached July 8, 1983 letter from Dean LeBaron, Chairman, Advisory Committee on Tender Offers, to Securities and Exchange Commission Chairman John S.R. Shad, transmitting the Report of Recommendations of the Advisory Committee on Tender Offers (Exhibit B).

(b) prohibit "golden parachutes" and defensive issuance or reacquisition of securities by target companies during tender offers which meet specified criteria; and

(c) prohibit "greenmail" unless approved by a majority of shareholders or unless an equal offer is made to all shareholders. 3/

III. Proposals for Tender Offer Regulation

The Senate Banking Committee, by letter dated September 27, 1984, requested that the Commission address four amendments proposed during Senate floor debate on S. 2851, the Financial Services Competitive Equity Act. The four amendments are: (A) legislative extension of the minimum offering period from 20 business to 60 calendar days proposed by Senator Howard Metzenbaum; (B) changes in regulation of two-tier and partial tender offers, proposed by Senator Arlen Specter and Senator Howard Metzenbaum; (C) imposition of a requirement that directors individually be required to own or agree to purchase 1,000 shares of stock in the issuers on whose boards they serve proposed by

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3/ The Commission had previously transmitted to Congress, on April 23, 1984, a legislative proposal entitled "The Shareholder Communications Act of 1984." This proposal, which would authorize the Commission to regulate the proxy processing activities of banks, associations and other entities in the same fashion as the Commission currently regulates broker-dealers, emanates from the Advisory Committee report, as well as from the recommendations of the earlier Advisory Committee on Shareholder Communications.

Senator John Chafee; and (D) creation of a federal cause of action to challenge corporate management decisions related to change of control transactions proposed by Senator John Chafee. The Commission's views on these four amendments are set forth below.

A. Minimum Offering Period Extension

Senator Metzenbaum's proposed amendment would require that tender offers be held open for at least a 60 calendar day period. This would approximately double the current 20 business day minimum offering period (approximately 28 calendar days), required by Rule 14e-1 (17 C.F.R. 240.14e-1).

In determining the appropriate length of the minimum offering period to be prescribed by Rule 14e-1, promulgated in December 1979, the Commission was guided by two basic goals: (a) to assure shareholders of target companies sufficient time to make and act upon informed investment decisions, and (b) to maintain the neutrality of the regulation between bidders and target companies to the extent consistent with the protection of shareholders as specified by Congress in adopting the Williams Act. 4/

This principle of neutrality was reaffirmed by Congress in 1976 when it adopted the Hart-Scott-Rodino Amendments ("HSR") to the Clayton Act. The committee report accompanying the

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4/ H.R. Rep. No. 1711, 90th Cong., 2nd Sess. 4 (1968).

amendments in discussing the abbreviated review period for HSR filings required in connection with cash tender offers noted that a basic principle underlying the Williams Act was to "maintain a neutral policy * * * [with respect to] tender offers, by avoiding lengthy delay that might discourage their chances for success." 5/

Following ten months deliberation, including analysis of approximately 100 written comments from law firms, corporations and others, the Commission adopted a 20 business day minimum offering period, after carefully considering and rejecting a 30 business day minimum period. The Commission concluded that a 20 business (28 calendar) day minimum offering period provides adequate opportunity for informed investment decisions and thus serves the purposes and policies of the Williams Act. 6/ Since adoption in December 1982 of Rule 14d-8 (17 C.F.R. 240.14d-8), shareholder complaints over the adequacy of the time have been negligible.

5/ H.R. Rep. No. 1373, 94th Cong., 2d Sess. 12 (1976).

6/ Release No. 33-6158 (November 29, 1979).

Prior to the adoption of Rule 14e-1, there was no specific minimum offering period under the Williams Act. As a practical matter, the seven day withdrawal period in Section 14(d)(5) of the Williams Act and the 10 day proration period in Section 14(d)(6) served to establish the federal minimum offering period for 100% and partial offers, respectively.

We would note that the report of the House Energy and Commerce Committee accompanying H.R. 5693, 7/ which would extend the minimum offering period to 40 calendar (29 business) days, does not suggest that shareholders need more time to make an informed investment decision. The House committee report speaks to the advantages to target company managements of the longer offering period and notes that it would provide more time for competing bids, and that various witnesses testified that extension of the minimum offering period would result in fewer tender offers.

The Commission's Advisory Committee on Tender Offers considered whether an extension of the minimum offering period was warranted. After careful consideration, the Advisory Committee concluded that extension of the minimum offering period was not necessary for shareholder protection and that an extension would not be consistent with the neutrality of the Williams Act. The Advisory Committee recommended that the minimum offering period for first bids be 30 calendar days (approximately 21 business days), with a shorter period for subsequent bids, and a longer period

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7/ H.R. Rep. No. 1028, 98th Cong., 2nd Sess. (1984).

for partial tender offers. 8/ As the Commission testified before the Subcommittee on Telecommunications, Consumer Protection, and Finance of the House Energy and Commerce Committee in March 1984, the Commission determined that adoption of the Advisory Committee's exact proposal would create an overly complex system, which might disadvantage non-professional shareholders. The Commission endorsed instead the 20 business day minimum offering period (28 calendar days) with prorationing and withdrawal rights throughout. 9/

At the present time, the weight of evidence is that the current offering period provides adequate time for shareholders to receive, consider and act on tender offer proposals. An extension may benefit some shareholders, but on balance it would increase the costs of the tender offer process unnecessarily, deter tender offers, and consequently undermine the basic principle of neutrality underlying the Williams Act.

Finally, the Commission believes that, in view of rapid developments in technology, the minimum offering period should be set by rule and not fixed by statute. Adjustments in the offering

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8/ The longer period was intended to be a disincentive to partial and two-tier offers.

9/ The Commission concurred in the Advisory Committee's recommendation to eliminate the automatic extension of withdrawal rights upon commencement of a competing bid. See Minutes of Commission open meeting on March 13, 1984.

period may prove necessary as means of communication with shareholders are improved. Such adjustments can be made more expeditiously if left to Commission rulemaking.

B. Regulation of Two-Tier and Partial Tender Offers

Senator Metzenbaum's proposed amendment provides that any person who makes a tender offer which would result in beneficial ownership of more than 20% of a class of a company's securities 10/ must make the same tender offer, request, or invitation to all shareholders. No exemptive authority is granted to the Commission, but an exception for issuer tender offers is included. This proposal simply requires that a tender offer be extended to all shareholders, if the bidder will own more than 20% of the class of stock. It does not require that the offer be made for all the shares. Thus, it would not address the issue of two-tier offers. Moreover, under the current law, the Commission already requires that any tender offer resulting in ownership of more than 5% of a class of stock must be made to all the holders on the same terms. 11/ The Commission believes therefore that this proposal is not necessary.

10/ The proposed amendment would apply to certain classes of equity securities, making it applicable during tender offers covered by Section 14(d) of the Exchange Act. This limitation is also contained in Senator Specter's bill.

11/ This applies to the same class of equity securities covered by Senators Metzenbaum's and Specter's proposed legislation.

S. 2448, introduced by Senator Specter, provides that any person who, after March 20, 1984, makes a tender offer which would result in the beneficial ownership of more than 20% of a class of a company's securities must make a cash offer for 100% of the outstanding shares of the class. 12/ An exception is provided for issuer tender offers, and the Commission is granted exemptive authority. S. 2448 would proscribe partial and two-tier offers but not additional share purchases in the open market or through negotiated transactions.

The Commission testified in March 1984 that federal regulation of partial tender offers and two-tier takeovers is a difficult and complex issue. It was the subject of substantial debate during the Advisory Committee's deliberations. Those who believed that partial and two-tier offers serve valid business purposes did not believe such offers require special federal regulation so long as there is an equal opportunity for all shareholders to participate in all phases of the bid. 13/

12/ This provision could affect the ability of companies to make investments in other companies that may be accounted for on an equity basis. Generally, such accounting triggers at the 20% level.

13/ In successful 1983-84 tenders for over 50% of the shares, 87% of the shares were tendered into the first step of two-tier offers.

They concluded that any additional regulation would adversely affect both shareholders and the markets. Others disagreed on the grounds that such bids are coercive. The Advisory Committee recommended that "the minimum offering period for a tender offer for less than all the outstanding shares of a class of voting securities should be approximately two weeks longer than that prescribed for other tender offers." The additional two weeks was intended to be a disincentive to partial and two-tier offers. The Advisory Committee's recommendation was based on a specific rejection of the argument that partial and two-tier bids should be prohibited.

The Commission is sensitive to the concerns which have been raised, but has not yet taken a position on two-tier and partial offers. It has solicited public comment on the issues and alternatives. (Release No. 34-21079 (June 21, 1984)). As discussed in Release No. 34-21079, the initial issue is whether partial and two-tier bids are harmful to target company shareholders.

The principal argument advanced by those who believe two-tier offers are harmful has been that they coerce shareholders to accept the initial offer, because if it is successful, they

will receive less in the second step. They apply the same logic to partial offers in which shareholders may receive less in subsequent offers or if they sell in the open market.

Those who argue against the need for restriction or prohibition of partial and two-tier offers contend that:

a) Partial offers have long been an accepted practice that serves valid business purposes, which include:
   - o allowing companies to invest in one or more industries with more limited financial exposure than 100% ownership;
   - o facilitating technology exchange relationships;
   - o permitting changes of control and reducing management entrenchment in large companies;
   - o facilitating private direct investment, such as venture capital;
   - o acknowledging common practices of foreign investors in the United States; and
   - o allowing acquirors to get to know a potential acquiree, before deciding to increase their investment.

b) To the extent that partial bids are restricted, concerns have been raised about immunizing large issuers from tender offers.

c) Two-tier offers cannot be regulated, without also regulating partial offers.

d) Two-tier offers provide substantial premiums to shareholders. Based on a study by the Commission's Office of Chief Economist, initial offers have been at a 64% average premium over the prior market price of the stock and the second step at a 47% average premium, a 55% average blended premium, as compared with 31% in partial offers (based on an average 46% premium in the tender offer and a 19% premium in the market following the offer) and a 63% average premium in all-or-any offers. While stocks generally decline to lower prices following partial tender offers, they have initially traded at a 19% average premium following the offer (unadjusted for market movements). 14/

e) Over the past three years, there has been a steady decline in the absolute and relative number of two-tier offers. In the fiscal year ended September 30, 1982, the 32 two-tier offers amounted to approximately 27% of all tender offers. In fiscal 1983, the 24 two-tier offers were 26% of all offers. In fiscal 1984, the 15 two-tier offers were 13% of all offers.

14/ See The Economics of Partial and Two-Tier Tender Offers, June 21, 1984, study by the Commission's Office of Chief Economist of 148 tender offers between 1981 and 1983 (included in Exhibit C).

f) Finally, rights of appraisal, class actions and other remedies against unfair transactions are available to shareholders under state and federal laws.

In addition to the Commission's economic analysis of tender offer premiums, the Commission has solicited public comment on several alternative approaches to two-tier offers, including:

a) The Advisory Committee's proposal to increase by two weeks the minimum offering period for such offers. A variation of this proposal would be to reduce the offering period required in a cash bid for all the shares.

b) A requirement that a bidder make a tender offer for all shares once a certain threshold of holdings is reached by the bidder. This is the S. 2448 approach. Proposals for triggering thresholds have ranged from as low as 10% to as high as 30%. Issues raised by this proposal are the effects on the costs of toe-hold acquisitions, the alienability of shares, and the economic consequences of so limiting the ability to make partial investments in public companies.

c) A proposal, derived from the British Takeover Code, that would require that partial offers to target company shareholders permit them to accept or reject the offer and also to vote for or against it in their letters of transmittal. The tender offer reply form thus would permit shareholders to exercise two choices in response to bids. First, shareholders may tender or not tender their shares. Second, they may vote for or against the offer. If they tender their shares and a majority of the shareholders vote against the offer, their shares will be returned and the bid will not be permitted to proceed. If they tender and a majority votes for it, their shares will be accepted even though they voted against it. Thus, in partial and two-tier offers, shareholders may tender while at the same time voting against them. This assures that if the holders of a majority of the shares approve the offer, dissenting shareholders will not have lost the opportunity to participate in the offer.

d) A proposal to limit two-tier offers, but permit partial offers, by requiring that all second step acquisitions of shares within a specified period of time be at least as high in price as the first step. The price of the partial offer would be the minimum the bidder could offer for additional shares. This alternative would

inhibit two-tier bids; however, as indicated above, shareholders have received significantly larger premiums in two-tier bids than in partial bids.

The Commission's solicitation of public comments included the tender offer study by its Office of Chief Economist cited above. This study covered 91 all-or-any, 32 two-tier and 25 partial tender offers in 1981-83. The data showed that the average premium for all-or-any tender offers was 63%. In two-tier offers, the average first-step premium was 64% and the average second-step premium was 47% (a blended premium of 55%). In partial offers, the average premium was 46% and the average market price following the offer (measured on the twentieth trading day after completion of the offer) was 19% for an average blended premium of 31% (unadjusted for market movements). Moreover, 72% of the two-tier offers had blended premiums above 40%, as compared with 68% of the all-or-any offers. 15/

Public comments in response to Release No. 34-21029 are still being received.

C. Share Ownership By Directors

Senator Chafee's proposed amendment, which is identical to his bill, S. 2797, proposes that the Exchange Act be amended to direct the Commission to require, by regulation,

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15/ The Release and Study are attached as Exhibit C.

that directors of publicly owned companies 16/ be required either to own at least 1,000 shares of stock in the issuers on whose boards they serve or to agree to "make perodic purchases of such shares using the total amount of that director's fees" from such issuer until 1,000 shares are purchased.

The Commission agrees that it is desirable for directors to own shares in their companies and believes most do. However, S. 2797 raises the following questions:

a) The qualifications of directors goes to the heart of corporate governance, an area widely accepted to be within the prerogative of state corporate law and the charter and by-law provisions of individual issuers. To begin to establish federal qualifications for directors of all public companies would be an extraordinary preemption of state corporate law.

b) Such a share ownership requirement could make it more difficult to recruit qualified directors. Even with the provision that the requirement may be met by the

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16/ S. 2797 applies to those companies whose equity securities are registered pursuant to Section 12 of the Exchange Act.

purchase of stock with directors' fees as they are paid, the requirement may discourage potential outside directors, particularly from academia, labor, consumer groups, minorities, and other constituencies. Those who would have to rely on the acquisition of stock through the application of fees may not be able to give their time in return for compensation which essentially takes the form of equity that must be held as long as they are directors. For example, a 1982 Commission study of 961 companies indicated that 77% paid directors annual compensation of less than $10,001. Assuming market prices of $10 to $50 per share, it would take at least one to five years for directors of these companies to satisfy a 1,000-share ownership requirement. They would receive no cash compensation for their time over such an extended period and would be required to pay taxes on their compensation, without receiving any cash to do so.

c) If directors of publicly owned companies who do not own shares were given such shares by the companies, all other directors could reasonably expect to receive similar treatment, which would dramatically increase the cost of directors' services to companies, and therefore their shareholders.

d) If issuers gave all directors 1,000 shares, plus sufficient cash to pay the resulting taxes, it would not only dramatically increase costs, it also would fail to achieve the intended effect of the requirement, since, unlike the shareholders, the directors would not have their own funds at risk.

e) In the case of penny stock companies, the 1,000-share requirement would be negligible.

D. Business Judgment Rule

Senator Chafee's proposed amendment is a provision of his bill (S. 2779) and also of S. 2777, introduced by Senator John Heinz. These bills would provide a federal cause of action for both the Commission and shareholders to challenge conduct by the board of directors of an issuer in connection with change of control transactions. The proposals would preempt the business judgment rule under state corporate law and would make all management actions in connection with changes of control subject to substantive federal regulation. S. 2779 and S. 2777 reflect concern with the "virtually unlimited discretion of management" to oppose takeovers through defensive maneuvers.

The Commission testified in March 1984 that it believes shareholders would be better served if the courts gave greater recognition to potential conflicts of interest between management and shareholders in change of control situations. However, the Commission has opposed proposals to define a federal standard for the conduct of the board of directors or to provide a federal cause of action for breaches of directors' fiduciary duties. Such proposals would be far-reaching preemptions of fundamental state corporate law.

Also, S. 2779 and S. 2777 are not limited to management responses to hostile takeovers. They would apply to all transactions "in contemplation of effecting, or of defending against, a change in control of such issuer." Thus, management's conduct in connection with major corporate actions that could affect control, such as mergers, liquidations, sales of securities, proxy solicitations and exchange offers, whether friendly or hostile, would be subject to substantive federal regulation. The need for such far-reaching preemption of state corporate law has not been demonstrated.

While there is a considerable body of case law that presumes the regularity of management conduct in change of control situations, there is evidence of an emerging judicial

sensitivity to conflicts of interest in changes of control situations. A recent example is the Second Circuit's decision in Norlin Corp. v. Rooney, Pace Inc., et al. 17/ In response to a perceived takeover threat, the board of directors of Norlin issued new common and voting preferred stock to a wholly-owned subsidiary and a newly created employee stock option plan, which was controlled by the directors. The district court granted a preliminary injunction barring the board from voting the stock in question. The court of appeals, in affirming the district court's decision, stated that a board member's obligation to a corporation under New York law has two prongs, a duty of care and a duty of loyalty. The court emphasized that the business judgment rule governs only situations in which the directors are not shown to have a self-interest in the transaction: "Once self-dealing or bad faith is demonstrated, the duty of loyalty supersedes the duty of care, and the burden shifts to the directors to 'prove that the transaction was fair and reasonable to the corporation.'" 18/

17/ [Current] Fed. Sec. L. Rep. (CCH) ¶91,564 (2d Cir. June 27, 1984).

18/ Norlin, ¶91,564 at p. 98,867, quoting Treadway Companies, Inc. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980).

The court found that the defensive tactics of Norlin's board of directors created "a strong inference that the purpose was * * * to solidify management's control of the company. * * * Where * * * directors amass voting control of close to a majority of * * * shares in their own hands * * * it strains credulity to suggest that the retention of control * * * played no part in their plans." 19/ The court's willingness to look closely at the potential for conflicts of interest in takeover situations, and its conclusion that, once such self-interest is indicated, "the duty of loyalty requires the board to demonstrate that any actions it * * * take[s] are fair and reasonable," 20/ may indicate that the greater judicial sensitivity desired by the Commission is developing.

IV. Conclusion

The four proposals under consideration are innovative approaches to important issues, but the Commission does not support these amendments at this time for the reasons set forth above.

19/ Norlin, ¶91,564 at p. 98,867.

20/ Id. at p. 98,868.

EXHIBIT A

JAKE GARN, UTAH, CHAIRMAN
JOHN TOWER, TEXAS
WILLIAM PROXMIRE, WISCONSIN
ALAN CRANSTON, CALIFORNIA
DONALD W. RIEGLE, JR., MICHIGAN
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
FRANK R. LAUTENBERG, NEW JERSEY
G. SANDY HALL, STAFF DIRECTOR
KENNETH A. McLEAN, MINORITY STAFF DIRECTOR

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

February 1, 1983

The Honorable John S.R. Shad
Chairman
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

We welcome the announcement that the Securities and Exchange Commission will shortly begin a full-scale study of the federal tender offer regulations, with an eye to proposing new legislation in Congress.

Commentators have suggested that the most feasible approach to current problems with tender offer law would be for Congress to revisit the program it began a decade ago, expanding the provisions of the Williams Act to deal with tender offer abuses, providing the judiciary with guidelines for determining the validity of challenges to bidder or management conduct during the course of an offer, and clarifying the respective rules of federal and state regulation.

The proliferation of contested take-overs over the past few years and the corresponding publicity has resulted in considerable Congressional interest in this subject. It would be most helpful to us if the Commission would address, among others, the following issues in its study:

What should be the role of the government in hostile take-overs?

What is a corporation's obligations to its shareholders, its employees, consumers, and the community in a take-over situation?

What abuses have occurred under current tender offer law?

Chairman Paul A. Volcker, of the Federal Reserve, has expressed concern "about take-overs distorting banking judgments or the credit markets." How might such distortions be prevented?

What should be the involvement of states in regulating corporate take-overs?

Should shareholders of a corporation be given the right to vote on proposed tender offers within a specific period of time of the offer, and should a shareholder majority be required to approve acquisitions and take-overs?

Are "golden parachute" provisions guaranteeing executives salaries and other compensation after any change of control of a company in the best interests of shareholders of that company? Should federal securities law require shareholder approval of golden parachutes or that their provisions be spelled out in detail in companies' proxy materials?

Should interest on money borrowed specifically to buy the common stock of another corporation in a take-over situation be tax deductible?

Should retained earnings used to acquire other companies be subject to a minimum merger tax?

Should additional time for competing bids be provided under a rule of auctioneering?

Should a federally imposed period of advance notice be established requiring a bidder to file registration materials with both the SEC and subject company management prior to the implementation of a tender offer?

Are individual shareholders currently receiving adequate and timely notice and information about take-overs (including competing offers)?

Do target corporations currently have sufficiently direct access to all their individual shareholders to conduct a responsible and reasonable defense against a hostile take-over?

It has been suggested that tender offers serve as an effective mechanism to discipline incompetent management and to permit the transfer of productive assets to the control of more efficient management. On the other hand, it has been agreed that the fear of hostile take-overs tends to focus management's efforts on short-run profits while giving less attention to longer term investments needed for economic growth. What role, if any, should federal regulation play in striking the proper balance between these conflicting concerns?

The Chairman and Chief Executive Officer of a company which was a major and successful player in a recent multibillion dollar acquisition contest has embraced the view that "Maybe there's something wrong with our system when .... companies line up large amounts of money in order to purchase stock, when it doesn't help build one new factory, buy one more piece of equipment, or provide even one more job." How, if at all, should federal regulation address this widespread frustration?

We recognize that a number of these issues are outside the direct jurisdiction of the Commission. However, it is our understanding that the Advisory Panel being put together by the Commission to study tender offers will be made up of outside professionals, including economists.

We believe that the public interest and the Congress would be best served by a broad study of the many issues surrounding tender offers and particularly hostile take-overs, and, therefore, we encourage the Commission panel to be comprehensive in both its approach and charter.

On July 13, 1979, the Banking Committee requested the Commission to review 7 specific questions concerning coverage of the Williams Act. The Commission provided its response on February 15, 1980. It would also be helpful if the Advisory Panel could review the questions and answers and provide any updating which the Panel may deem necessary.

To assist us in considering this subject, we would appreciate receiving the study and recommended legislation from the Advisory Panel by July 31, 1983.

Sincerely,

Alfonse M. D'Amato

Paul S. Sarbanes

Slade Gorton

Donald W. Riegle

John Heinz

Christopher J. Dodd

Paula Hawkins

Alan J. Dixon

Mack Mattingly

Alan Cranston

Jake Garn, Chairman

William Proxmire
Ranking Minority Member

EXHIBIT B

July 8, 1983

John S.R. Shad
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Shad:

We are enclosing the final report of the Commission's Advisory Committee on Tender Offers which was established on February 25, 1983. The eighteen members of this Advisory Committee met six times in full session. Countless meetings of six sub-committees were held to prepare recommendations to the full body. We had the benefit of extensive experience of our individual members in completing our assignment within our original time frame.

The summary report emphasizes that we concentrated our work and recommendations on shareholders' interests. We are cognizant, however, of interest in takeovers on broader governmental, societal, jurisdictional planes and have touched on these issues in our work. We specifically address some questions put to us through the Commission that express Congressional concerns.

Our recommendations are detailed, technical and comprehensive. We expect the Commission to put them in place by rule making or by recommending legislation, or regulation, as may be required, as they stand. They are designed to be an integral and cohesive body.

I would like to point out the fundamental bases upon which our recommendations rest. There are other technical solutions which are consistent with our fundamental policy objectives. Throughout the meetings of the Committee we encouraged diversity of opinion and dissent. One of our functions was to bring out a number of ideas which might otherwise have become buried in a carefully negotiated majority view. We hope the Commission will draw upon this diversity of views in reaching your ultimate decisions.

The Committee respects the free market forces in the operation of the U.S. securities markets. Academic evidence is widespread that the takeover process is at least not demonstrably harmful to shareholders and some evidence points to its systematic benefits. We would be reluctant to restrict a process which seems to work reasonably well with the possibility that we might incur some unintended harm. The Committee is humble in its ability to anticipate all of the

takeover innovations that are likely to occur: good and bad. Our instincts led us to rely upon competitive markets as the ultimate regulator for the unforeseen specifics that may affect security holders. Our recommendations should promote private investment systems rather than hamper capital flows by heavy reliance upon rule making. We are attracted to solutions which are characterized by flexibility, simplicity and lower costs.

A theme running through our recommendations is to promote the disclosure of meaningful information to all investors. The tender offer process seems the best way available to us of insuring that terms, price and conditions are made available equally to all shareholders in a timely fashion. We suggest that purchases above 20% ownership be offered to all shareholders through the tender process.

We resist the temptation to bar substantial partial positions in companies. In most instances, we would expect that the acquisition of control would be accompanied by the purchase of all shares. There are circumstances in this country, as in international markets, where partial participation establishes business relationships which encourage cooperation and productive sharing of skills. We would not wish to alter these affiliations. We do, however, recommend that the partial positions receive somewhat less favored treatment than purchases which are contemplated to be for an entire company.

We are introducing an improvement in shareholder democracy in the form of advisory votes. We do believe that shareholders should have a mechanism to express their periodic will on charter provisions which may limit conditions under which their stock may be sold. Company directors, on the other hand, should not be bound to act against their business judgment in the shareholder interest. We do believe that the advisory vote concept will become a useful device in measuring shareholder sentiments.

We encourage procedures which will equate the offering of cash and securities. A number of purchases are accomplished initially for cash because Commission procedures are simplified for cash, and then are converted later into securities. Should cash and securities be administratively equated in the first instance, the latter potentially cumbersome and expensive step can be eliminated.

Throughout our discussions we have argued for simplicity in the procedures which may be required. This simplification may in some measure counteract the almost natural attraction to an elegance of rule making to guard against a number of perceived evils, especially those of recent anecdotal evidence.

Documentation by academic sources, business reports and the Commission staff were very helpful in our deliberations. We benefited from a review of takeover practices in other countries which included generous personal visits by United Kingdom and Canadian representatives.

The committee would have been unable to complete its work without the competence, diligence and hard work of the staff assigned to it. David Martin, Secretary to the Committee, did excellent work in keeping us administratively on track. Linda Quinn, Associate Director, diplomatically functioned in a continuing and important role.

Finally, we hope that the Commission and its staff will draw upon the Committee members for their advice and counsel in the future as you wish. Although we are disbanded with this report, our interest has not lessened and our willingness to serve remains keen.

Sincerely,

Dean LeBaron
Chairman
Securities and Exchange Commission
Advisory Committee on Tender Offers

EXHIBIT C

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-21079; S7-24-84]

Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs—Advance Notice of Possible Commission Actions

AGENCY: Securities and Exchange Commission.

ACTION: Request for public comment.

SUMMARY: The Commission is studying two-tier pricing in tender offers and non-tender offer purchase programs. This review has evolved from recommendations proposed to the Commission by its Advisory Committee on Tender Offers. The Commission is requesting public comment on these

recommendations as well as on other proposals, issues and data described in this release. This initiative will assist the Commission in its review of the tender offer regulatory scheme. The Commission will review comments made in response to this release with a view toward possible rulemaking and legislative proposals.

DATE: Comments should be received on or before September 14, 1984.

ADDRESS: Comment letters should refer to File S7-24-84 and be submitted in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, D.C. 20549. The Commission will make all comments available for public inspection and copying in its Public Reference Room 450 Fifth Street, NW., Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT: Joseph G. Connolly, Jr. or Robert E. Burns, ((202) 272-3097), Office of Tender Offers, Division of Corporation Finance, or, regarding the Report that is an annex to this release, Gregg A. Jarrell ((202) 272-7102), Chief Economist, Securities and Exchange Commission 450 Fifth Street, NW., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. Executive Summary

The Securities and Exchange Commission (the "Commission") is considering two practices in the change of control area that have raised serious concerns and have come under increased scrutiny. The first is an acquisition, initiated by a tender offer, where the per share consideration is higher for one portion of the shares to be acquired than for the other portion ("two-tier pricing" or a "two-tier bid").[1] The second is the acquisition of a significant percentage of stock through open market or privately negotiated purchases.

The issues surrounding two-tier pricing and non-tender offer acquisition programs have been focused recently by the Report of Recommendations of the Commission's Advisory Committee on Tender Offers.[2] The Advisory Committee identified concerns with these practices and made proposals to address those concerns.[3] The Commission expressed reservations with those recommendations and has initiated a study of the issues in this area.[4] As part of the study, this release discusses concerns regarding two-tier bids and open market or privately negotiated purchase plans. It identifies possible solutions to alleviate these concerns, including the Advisory Committee's recommendations, and requests pubic comment.

Finally, as a further part of the Commission's study, the Office of the Chief Economist ("OCE") has compiled data regarding successful tender offers in calendar years 1981-1983. This study covers 91 any-or-all, 32 two-tier, and 25 partial tender offers. The data show that the average premium for the any-or-all tender offers is 63.4 percent, compared with an average blended premium of 55.1 percent for two-tier offers, and 31.3 percent for partial tender offers. A closer comparison of any-or-all uniform premiums with two-tier blended premiums shows that 68 percent of the any-or-all offers have premiums above 40 percent, while 72 percent of the two-tier offers have blended premiums above 40 percent. This study is attached as an annex to this release and provides complete detailing of the sample studied and the methodology used. Commentators are requested to comment upon the OCE Report and suggest further research directions.

II. Concerns With the Practices and Recommendations of the Advisory Committee on Tender Offers

A. Two-Tier Pricing

The two-tier bid is a recent practice that has evolved from the partial tender offer. The partial tender offer itself is not new. As a bidding practice it has been used for many years in a variety of ways—standing alone or as part of a series of transactions such as an open market acquisition, followed by a partial tender offer, followed by a final merger.[5] As noted above, of the 148 successful tender offers included in OCE's three-year sample, 32 are two-tier offers, 25 are partial offers and 91 are any-or-all offers. Recently, the partial offer has been amplified by the two-tier bidding strategy where a proposed second step, lower priced acquisition of the minority interests is disclosed in the first step partial tender offer.[6]

Concerns with two-tier pricing pivot principally around what many see as coercion or pressure on shareholders to tender into the first step cash tender offer.[7] The alternative of not accepting the tender offer is virtual assurance that, if the offer is successful, the shares will have to be sold in the lower priced, second step.[8] Given that pressure, it is

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[1] A two-tier bid usually involves an acquisition that is accomplished in two steps. In the first step, the bidder uses a tender offer to buy, at a premium price and generally for cash, enough shares to establish a controlling position in the target. Once control is established, the offeror will take the second step in the acquisition, a merger of the target into the bidder or a subsidiary, freezing out minority shareholders with a forced acceptance of cash or securities valued at a lower price than the original tender offer. The second step merger generally is disclosed in the tender offer materials and usually involves securities of the bidder.

[2] Advisory Committee on Tender Offers, *Report of Recommendations* (July 8, 1983) ("Advisory Committee Report"). The Advisory Committee was established by the Commission to examine the tender offer process and other techniques for acquiring control of public issuers and to recommend to the Commission appropriate or necessary legislative and regulatory changes. *See* Release No. 34-19628 (February 25, 1983) [48 FR 9111, March 3, 1983]. Members of the public may obtain copies of the Advisory Committee Report, on a one per request basis, by sending a self-addressed 9×12 inch envelope with prepaid postage of $3.20 affixed, to Securities and Exchange Commission, Publications Section, Public Reference Branch, Stop 1-2, 450 Fifth Street, NW., Washington, D.C. 20549.

[3] Advisory Committee Recommendation 16 proposed that a partial offer have a longer minimum offer period than a bid for all shares. That regulatory disincentive would tend to mitigate what the Committee saw as the coercive elements of partial and two-tier bids. Recommendation 14 proposed that any acquisition resulting in total ownership of over 20 percent of the voting power of an issuer be made by tender offer. Such a provision was intended to assure equal opportunity for all shareholders be benefit from any premium associated with a control acquisition, an opportunity the Advisory Committee believed was not available where control passed through a non-tender offer acquisition program.

[4] The Commission considered all of the Advisory Committee's recommendations at its open meeting on March 13, 1984. Chairman Shad testified as to the Commission's positions on March 28, 1984 before the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce. The Commission is now engaged in a three part response to the Advisory Committee's Report: first, proposed legislation (*see* Tender Offer Reform Act of 1984 (H.R. 5693, 98th cong., 2d Sess. (1984)) submitted by the Commission to Congress on May 21, 1984 and introduced on May 22, 1984); second, proposed rulemaking; and third, further study on certain issues.

[5] *See, e.g.*, Freund & Easton, *The Three-Piece Suitor: An Alternative Approach to Negotiated Corporate Acquisitions*, 34 Bus. Law. 1679 (1979).

[6] Some, including certain members of the Advisory Committee, argue that even the pure partial offer is a two-tier bidding strategy, where the first step is a cash tender offer and the second step is the open market.

[7] The OCE Report computes the first- and second-tier premium in two-tier offers to determine if first-tier premiums encourage shareholders to tender into an offer with a lower second-tier premium. OCE finds that the second-tier premium equals at least 80 percent of the first-tier premium in over three-fourths of the cases and most second-tier premiums are equal to at least 90 percent of the first-tier premium. The average first-tier premium in two-tier offers is 63.8 percent, and the average second-tier premium is 47.1 percent. The average bid premium in partial tender offers is 45.0 percent. The Commission notes, however, that the OCE Report does not attempt to determine the extent to which "market professionals" or any other group of shareholders of a target may receive a disproportionately high percentage of the first tier premium.

[8] The pressure based on price differential in the first and second step can be accentuated where the consideration in the second step is securities whose market value may be less than stated value.

argued that there is no realistic means for shareholders to reject a two-tier bid, even where they believe the combined, or blended, first and second step price for the target is too low.[9]

The Commission's Advisory Committee on Tender Offers identified many of these concerns with coercive effects of two-tier bids. Indeed, the Advisory Committee considered these concerns to be applicable to partial offers as well. The Committee proposed that a regulatory disincentive be placed on all partial offers. That disincentive would be substantially longer minimum offering period than that applicable for an offer for all shares ("full bid").[10] This was expected not only to encourage the use of the full bid but also to offset to some degree the advantage of a two-tier bid.

The Advisory Committee envisioned an extension of the offering period for a partial bid beyond the current, 20 business day minimum offering period for a full bid.[11] The concept of different time periods for partial and full bids, however, could also be implemented by reducing the full bid period and leaving partial offers on the current time schedule. For instance, the minimum offering period for a full bid could be reduced to 10 business days, and the partial offer could be left at 20 business days. Commentators are specifically requested to address this alternative along with that of the Advisory Committee.

The Commission is sensitive to the Committee's concerns regarding two-tier and partial offers. At its meeting on March 13, however, the Commission stated that it did not think the Committee's recommendation is the best way to address these concerns. The Commission's reservation is based on a number of points.

First, the Commission is not satisfied that the case for the supposed coercion in a two-tier bid has been made with sufficient precision. In this regard, the Commission notes that any tender offer, and particularly any partial tender offer, involves an element of coercion or pressure. The Commission requests commentators to address specifically cases in which two-tier bids have created pressure on shareholders which is different than that present in other tender offers.

Second, assuming that the two-tier bid is unduly coercive, the Commission is not certain that the two week extension of the minimum offering period for the partial offer recommended by the advisory Committee is a strong enough response. Currently, there is a timing disincentive for the partial bid. This arises from the ability of a bidder in a full bid to begin purchases upon the termination of the withdrawal rights. With a partial offer, purchases cannot commence until the expiration of the offer.[12] Notwithstanding this disparity, however, it is not clear that it has discouraged bidders from using the two-tier bidding strategy. Commentators are requested to address this point specifically in their comment letters.[13]

Third, aside from questions about the effectiveness of the proposal, the Commission is concerned with any regulation that does not distinguish the two-tier bid from the partial offer. The partial tender offer has long been an accepted bidding practice which can serve valid business purposes.[14] The Commission specifically requests commentators to discuss whether it is appropriate to regulate two-tier bids in a way that would also regulate partial offers. Further, it requests comments on whether in is possible to formulate regulation that distinguishes between partial and two-tier offers.

Fourth, the Commission believes that any restriction on two-tier pricing must appreciate the impact of the regulation on broader corporate control transfer issues. For instance, if two-tier bidding is restricted, will there be fewer bids made? Or, alternatively, will restrictions on two-tier bidding simply force bidders into pure partial tender offers with no second step into which minority shareholders can sell? The OCE study shows that any-or-all tender offers are common for small target firms, while partial and two-tier offers predominate among larger targets, as measured by the market value of equity. If two-tier bidding is restricted, will the distribution of tender offers by firm size change?

Finally, the Commission believes there is some indication that recent regulatory changes and proposals may effectively reduce the appeal of two-tier pricing for bidders. Since the Commission adopted Rule 14d-8 (*see* Release No. 34-19336 [December 15, 1982]), which eliminated the use of multiple proration pools by requiring that proration rights be extended throughout the offering period of any partial offer, there has been a decline in the use of two-tier pricing in tender offers. *See* OCE Report. Futher, the Advisory Committee proposed, and the Commission concurred, that cash and exchange offers be placed on a more equal regulatory footing.[15] Under current regulations, because of the need to register securities to be offered in exchange, the Advisory Committee found that there was major disincentive to using securities as consideration in a tender offer. To the extent that regulatory disincentives are reduced for exchange offers,[16] the Commission requests comment on whether bidders may find it less necessary to structure bids with a high cash front end and a lower priced securities back end or whether bidders may have greater flexibility to design other forms of two-tier bids.

B. Open Market or Privately Negotiated Purchase Programs

The second area the Commission is studying involves the acquisition of a

[9] So effective is the pressure of the two-tier bid, some have theorized, that it is possible for a two-tier bid with a lower blended price to prevail over a higher priced offer for all the shares. This may result because the risk of proration in a two-tier offer is reduced by the likelihood of shareholders tendering into the competing bid and the fact that a percentage of shareholders may not tender into either offer. On the basis of the 1981–1983 data in the OCE Report, there is no evidence of a two-tier bid with a lower blended price prevailing over a higher priced offer for all the shares. *See* section V of OCE Report.

[10] *See* Advisory Committee Report at Recommendation 18 which provides as follows:

The minimum offering period for a tender offer for less than all the outstanding shares of a class of voting securities should be approximately two weeks longer than that prescribed for other tender offers.

[11] *See* Rule 14e-1 (17 CFR 240.14e-1).

[12] Under Rule 14d-7 (17 CFR 240.14d-7) any person who has deposited securities in a tender offer has a right to withdraw those shares for the first 15 business days of the tender offer. Thus, after that, the bidder in an offer for all the outstanding securities may commence purchasing. Where the offer is for less than all the shares, however, Rule 14d-8 (17 CFR 240.14d-8) requires proration rights to be extended throughout the offering period. The bidder, therefore, cannot commence purchases until the expiration of the offer because it cannot determine the proration factor until the offer expires.

[13] In addressing this point, commentators should note that the Advisory Committee recommended, and the Commission concurred, that withdrawal rights be extended throughout the offering period. *See* Advisory Committee Report at Recommendation 17. The Commission will make this the subject of a separate rulemaking proposal.

[14] There was substantial sentiment on the Advisory Committee itself that partial tender offers are important to the economy. The Report cited six valuable roles for partial offers. *See* Report at pp. 24–25.

[15] *See* Advisory Committee Report at Recommendations 5, 11, and 12.

[16] The Commission has proposed for comment a new form, Form S-4, for registration of securities in business combinations which, if adopted, would implement the Advisory Committee's proposal to extend principles underlying the integrated disclosure system to exchange offers. *See* Release No. 33-6534 (May 8, 1984) [49 FR 20033]. Another element of the Advisory Committee's recommendation which involves commencing bids and receiving tenders prior to the effective date of the registration statement will be the subject of a separate rulemaking project.

significant position through open market or privately negotiated purchases. Concern here is raised by the fact that where such purchases do not involve a tender offer [17] and where control passes as a result of the purchases, there are not the same substantive protections as would be present if the acquisition had been by tender offer. In a tender offer, the bidder must provide disclosure about the offer, keep the offer open for a minimum period of time, provide the substantive protections of withdrawal, proration and the best price rule, and make the offer to all shareholders. The tender offer procedure and regulations will assure that market forces will price the premium and that this premium is offered to all shareholders. Those same assurances do not exist in ordinary open market or privately negotiated purchase programs which are regulated essentialy from a disclosure standpoint.[18] Thus, although it may have substantially the same effect as a tender offer, the open market or negotiated acquisition program has the tendency to proceed with the lowest control premium and to pass that premium to a selective group of shareholders.[19]

Additional regulation of these acquisitions has been proposed form time to time by the Commission [20] and was addressed by the Advisory Committee specifically. The Advisory Committee proposed that any acquisition resulting in total ownership over 20 percent of the voting power of an issuer be required to be made by a tender offer.[21] Above the 20 percent threshold, this proposal would eliminate concerns of those who believe open market or privately negotiated purchase programs unfairly and unevenly set and distribute control premiums. The recommendation is founded on the premise that control is a corporate asset and that shareholders should have an equal opportunity to share in the premium paid for that asset.[22]

At its meeting on March 13, the Commission expressed serious reservations about the Committee's proposal. Principal among the drawbacks with such a proposal is the regulatory burden that it would place on all forms of acquisition that result in more than percent ownership, even those where control is not the ultimate objective. For instance, the proposal could inhibit such acquisitions as those for investment or technology transfer purposes by increasing the expense of assembling such holdings and by decreasing the alienability of blocks in excess of 20%. The proposal, which would represent a fundamental change in the current system, could have significant impact on capital formation and corporate governance. The Advisory Committee itself acknowledged the difficult issues that such a proposal would present, noting its own "extended debate" on the question.

III. Alternative Proposals

In addition to the proposals of the Advisory Committee and the legislative and rulemaking proposals of the Commission in 1979 and 1980,[23] three alternative proposals have been made to address two-tier bids and non-tender offer acquistion programs. The first would require a bidder to make a tender offer for all the shares of a class once holdings in that exceed a certain threshold. The key determinant with this suggestion is the level of the trigger threshold. Various proposals have ranged from as low as 10 percent to as high as 30 percent. As noted by the Advisory Committee, under the regulation of takeover bids in the United Kingdom, the City Code on Take-overs and Mergers ("City Code") imposes a general obligation to make an offer for all shares if the amount owned or sought exceeds 30% of the outstanding shares.[24]

Consequences of this type of regulation, which combines certain policy elements of the Advisory Committee's Recommendations 14 and 16, are similar to those already described. A system that requires the tender offer to be used above a certain threshold could increase the costs of toe-hold acquisitions and restrict the alienability of blocks. Moreover, a system that requires a tender offer for all the shares above a certain threshold could limit partial ownership of companies, an economic consequence of uncertain limits. In addressing this alternative commentators are requested, if they believe a threshold is appropriate, to indicate at what level they would place it and why.

The second proposal also derives from the British system of regulation. Under the City Code, a letter of transmittal by which target company shareholders respond to an offer must provide an opportunity to approve or disapprove an offer for less than all of the outstanding shares.[25] The tender offer reply form thus permits the shareholder to exercise two choices in response to the bid. First, the shareholder may tender or not tender shares that are the subject of the offer. Second, the shareholder is permitted to vote for or against the offer. If a majority of the shareholders vote against the offer, the shares will be returned and the bid will not be permitted to proceed. Thus, in the case of a partial offer, including an explicit two-tier priced offer, a shareholder may tender shares and vote against the transaction at the same time.

This type of provision appears to eliminate effectively the perceived coercive aspects of the two-tier bid that have evoked concern. A shareholder who is not satisfied with the price of the offer, in either the first or the second step, but who feels compelled to tender shares into the first step tender offer, may at the same time protect his or her position by voting against the offer. To the extent that the market as a whole concurs, the regulatory system would

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[17] Courts have found that certain purchase programs constitute tender offers. *See, e.g., Wellman* v. *Dickinson*, 475 F.Supp. 783 (S.D.N.Y. 1979); *S-G Securities, Inc.* v. *Fuqua Investment Co.*, 466 F. Supp. 1114 (D.Mass. 1978); *Cattlemen's Investment Co.* v. *Fears*, 343 F.Supp. 1248 (W.D.Okla. 1972).

[18] *See* 10(b) and 13(d) of the Securities Exchange Act of 1934 [15 U.S.C. 78a *et seq.*] (the "Exchange Act"). Section 10(b) is the general antifraud provision of the Exchange Act. Section 13(d) requires certain disclosure within 10 days after an acquisition that results in a beneficial ownership of more than 5% of an issuer's registered equity securities. Recently, the Commission has proposed legislation that would empower it to close the 10-day window period in section 13(d). *See* H.R. 5693, 98th Cong., 2d Sess. (1984). That legislative proposal was in direct response to Advisory Committee Recommendation 13.

[19] For a general discussion of the impact on target shareholders of the open market or privately negotiated acquisition program, *see* Maiwurm & Tobin, *Beachhead Acquisitions: Creating Waves in the Marketplace and Uncertainty in the Regulatory Framework*, 36 Bus. Law. 419, 425–28 (1983).

[20] In 1979, the Commission proposed a regulatory structure that would require the use of a tender offer for an acquisition above a specified threshold of beneficial ownership. *See* Release No. 34–16385 (November 29, 1979). These rules were not adopted. In 1980, the Commission proposed legislation that would have effected a similar result. *See* S. 3186, 96th Cong., 2d Sess. (1980). The legislation was not enacted. *See also* note 17.

[21] *See* Advisory Committee Report at Recommendation 14 which provides as follows: No person may acquire voting securities of an issuer, if, immediately following such acquisition, such person would own more than 20% of the voting power of the outstanding voting securities of that issuer unless such purchase were made (i) from the issuer, or (ii) pursuant to a tender offer. The Commission should retain broad exemptive power with respect to this provision.

[22] The question whether control should be deemed a corporate asset has been debated for some time. *See, e.g.*, Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 Harv. L. Rev. 505 (1965); Berle, *"Control" in Corporate Law*, 58 Columb. L. Rev. 1212 (1958). *See also Perlman* v. *Feiamann*, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955).

[23] *See* note 19.

[24] *See* Rule 34 of the City Code.

[25] Under the City Code, partial offers are permitted under certain circumstances. *See* Rule 27 of the City Code.

provide a mechanism for the coalescence of that estimate.

A third approach would permit partial offers but would require any second-step acquisition within a specified period to be of at least equal per share value. Under this proposal, a bidder could make a partial tender offer. Any further acquisitions within a specified period, two years for instance, whether by merger, tender offer, or non-tender offer purchases, would only be permitted if the consideration was of at least equal value per share as that given in the first step partial tender offer. This proposal would mitigate against the perceived coercive effects of both partial and two-tier offers by eliminating the price differential between the initial tender offer and the second step take-out merger or the open market absorption of minority interests.

IV. Specific Questions

In addition to Advisory Committee Recommendations 14 and 16, the alternative proposals described in Part III, and other specific inquiries in Parts II and III, commentators are requested to consider the following questions.

1. Is two-tier pricing an acceptable means to induce tendering?

2. Is a two-tier offer coercive, and, if so, how and in what situations is it most coercive?

3. Does the partial offer with no stated second step involve less certainty and more coercion than the explicity two-tier bid, and if so, explain how?

4. Is it possible to regulate two-tier offers without also regulating partial offers, and, if so, how?

5. Is a partial offer inherently more complicated than an offer for all shares, and, if so, is it necessary to keep a partial offer open longer than a full offer in order to give shareholders time to evaluate its terms?

6. If regulation restricted bidders to using only tender offers for all shares, would this have a chilling effect on takeover activity and, if so, how?

7. As a conceptual matter, should "control" in any form be deemed a corporate asset, and why?[20] If so, for what form of "control" is that premise most apt?

8. Should federal regulation be structured around the premise that "control" is a corporate asset, and, if so, what system of regulation is most appropriate?

9. What are the principal benefits and detriments to an open market or privately negotiated acquisition program to obtain control?

10. If a non-tender offer acquisition program occurs over a long period of time and incremental acquisitions are fully disclosed, are there still adverse consequences that require additional regulation?

11. Should the regulatory scheme assure that the tender offer is the fastest means to acquire a substantial percentage of an issuer's equity?

12. What would be the economic consequences of a regulation that prohibited open market acquisitions above a certain threshold, and required that above that threshold any acquisition be made by a tender offer?

13. Some reason that, from an economic standpoint, the partial offer should always have a higher premium than the full offer. Assuming this is true, if the initial bid is two-tier priced, will the high premium in the first step partial tender offer necessarily force a subsequent competing bidder to use a two-tier bid, as opposed to a full bid. If so, why? If not, why not?

14. It has been argued that the partial offer can induce shareholders to accept less than the best alternative. Is that argument apt and if so, would a requirement that target company shareholders approve a partial tender offer in the manner described in Part III resolve the predicament?

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

Dated: June 21, 1984.
By the Commission.

George A. Fitzsimmons,
Secretary.

The Economics of Partial and Two-Tier Tender Offers

Concern over partial and two-tier tender offers is very evident. The Securities and Exchange Commission's Advisory Committee on Tender Offers noted those concerns and suggested possible regulatory changes. Recent legislative proposals would severely hinder the use of partial or two-tier tender offers. Before regulatory changes are pursued however, a comprehensive economic analysis of partial and two-tier tender offers is required. In this paper, we consider tender offers in 1981, 1982 and 1983, and relate empirical information on partial and two-tier tender offers to the controversy surrounding them.

Our attention is focused on the premiums paid to target shareholders in partial or two-tier offers as opposed to any-or-all offers. A predominant concern when any-or-all offers are not used is that target shareholders may be encouraged to tender in the first tier when the offer price of the second tier is substantially lower (or nonexistent in partial offers). We compare the overall "blended" premium in partial and two-tier tender offers (a weighted average of first- and second-tier premiums) to any-or-all premiums to determine relative premiums paid to target shareholders in each case. In addition, we note other characteristics of partial and two-tier offers. Frequency of these offers over time and possible rationale for such offers are considered.

This memorandum is organized into several sections. The first section is a brief overview of the criticism of partial and two-tier offers. The second section describes our data and empirical methodology. The third section considers some theoretical explanations of partial and two-tier tender offers. The fourth section relates our empirical information to the controversy. Section five reviews multiple bidder contests. A summary and conclusion ends the paper.

Our study reveals these characteristics of any-or-all two-tier and partial tender offers in 1981, 1982 and 1983:

- Any-or-all offers are more frequent than partial and two-tier offers (91 as opposed to 57). However, the incidence of any-or-all offers is much higher among smaller targets while partial and two-tier offers predominate among medium-size and large targets.
- Any-or-all offers yield a higher overall premium (63.4 percent) than the blended premiums in two-tier (55.1 percent) and partial (31.3 percent) offers. Any-or-all premiums and two-tier blended premiums are very similar in magnitude—72 percent of two-tier premiums exceed 40 percent while 68 percent of any-or-all premiums do so.
- The first-tier of a two-tier offer is virtually equal to the overall premium of an any-or-all offer at 63.5 percent. However, the offer premium of partial offers is lower at 45.9 percent.
- Nearly three-fourths of the 32 two-tier offers have less than a 20 percent difference between the first- and second-tier premiums. In contrast, less than half of the 25 partial offers have less than a 20 percent difference between the offer price and the post-offer trading price.

I. The Controversy Behind Partial and Two-Tier Tender Offers

In Release No. 34-21079, the Commission describes the concerns surrounding partial and two-tier offers. Central to these concerns is that target shareholders may be induced to tender

[20] *See* note 21.

to a partial or two-tier offer when an alternative any-or-all offer may have a higher overall premium. A two-tier offer might be accepted over an any-or-all offer in this case because shareholders tender to a high first tier to avoid a relatively low second tier. Though shareholders would be better off on an overall basis if they tendered to the any-or-all offer rather than tendering to the two-tier offer, shareholders are not certain which offer will be accepted. A situation is created where shareholders may tender to the first tier of the two-tier bid because of fear of being forced to accept a lower second-tier offer if the bidder obtains control in the two-tier offer. Commentators suggest that this process is coercive and encourages shareholders to tender when the overall two-tier premium is not as attractive as existing or potential any-or-all offers.

Our research focuses on identifying partial and two-tier offers and computing any-or-all, first-tier and "blended" premiums (which combine first-tier and second-tier premiums).

These premiums are compared for evidence of shareholders accepting relatively low overall bids in partial or two-tier offers or indications of coercive behavior. In addition, the frequency of such offers and the role of these offers in takeovers are studied. It is hoped that the evidence presented will provide a springboard for further discussion and reserach.

II. Data and Methodology

The debate surrounding partial and two-tier offers lacks empirical evidence. Although commentators from investment banking firms and other industry sources are very knowledgeable about partial and two-tier offers, there has been no data compiled to specifically address the empirical questions arising in this issue.

The Austin data base compiles all tender offer filings at the Commission and provides details on offer terms and target characteristics.[1] From this data base, we take all "successful" cash offers (defined as those in which some target shares were purchased) in 1981, 1982 and 1983.[2] For these offers, we compile a data base detailing offer terms, pre- and post-offer prices of target shares, and other information such as total number of target shares and number of shares held and sought by the bidder.[3]

In general, tender offers may be divided into two basic groups depending on whether prorationing is a factor in the bid. An any-or-all offer states that the bidder will buy any-or-all tendered shares of the target firm, as long as some minimum conditions are met. In general, such conditions related to a minimum number of tendered shares to insure control. In an any-or-all offer, the target shareholder knows that all of his tendered shares will be purchased at the offered premium as long as the minimum conditions are met.

The second type of tender offer is one in which the bidder states a maximum number of shares to be purchased in addition to a minimum condition. If the offer is oversubscribed, the tendered shares will be subject to prorationing. When the offer is executed under prorationing, each tendering account has the same fraction accepted. Prorationing requirements insure that each target shareholder receives proportionate share of the terms of the tender offer.

This second type of offer may be divided into several subgroups. A *pure partial offer* we define as one in which there is no announced second-tier offer during the tender offer and no clean-up merger of tender offer closely following the execution of the tender offer. Assuming the partial offer is for control off the target firm and is successful, a minority interest is left trading the target firm's shares in the market. Following the execution of the tender offer, it should be noted that the trading price is generally lower than the offer price. This trading price of the target shares is essentially the second tier of a partial offer.

A two-tier offer combines a partial tender offer for control with an offer for remaining shares following the execution of the original tender offer. In an *explicit two-tier* offer, the bidder, at the time of the first-tier offer, agrees with target management to purchase the remaining shares following the execution of the first-tier. The first tier usually is for controlling interest in the target firm and almost always offers cash for the target shares. The second tier is more likely to offer securities for the remaining shares after the cash first-tier offer closes successfully. The first-tier price is offered to shareholders on a prorata basis and the value of the second-tier offer is less than the first-tier offer on a per-share basis.

An *implicit two-tier* offer lies between the pure partial offer and the explict two-tier offer. Though no second tier is agreed to at the time of the original offer for control, a second tier is revealed shortly after the execution of the offer. The second-tier price in implicit two-tier offers is again generally lower than the first-tier price and offers securities for the target shares. The second-tier offer often takes the form of a merger.

Central to our research is the determination of premiums paid in the various categories of tender offers. The premium of the any-or-all offer is simply the precentage difference between the tender offer price and the pre-offer price:

$$(1)\ P_A = (P_T - P_M)/P_M$$

Where:

P_A = any-or-all tender offer premium,
P_T = price offered for target shares, and
P_M = pre-offer market price of target shares.

The premium of partial and two-tier tender offers is more difficult to determine. The "blended" premium we compute reflects the overall premium paid to all outstanding shares, where the premium paid to each tier is weighted by the fraction of shares receiving that premium. This blended premium is applicable to pure partial, explicit two-tier and implicit two-tier offers. In a pure partial offer, the price of the remaining traded shares is essentially the second-tier price. We express the blended premium as:

$$(2)\ P_B = (F \times T_1) + [(1-F) \times T_2].$$

Where:

P_B = the blended price of the offer,
T_1 = the per-share, first-tier offer price,
T_2 = the per share, second-tier offer price,
F = the fraction of outstanding shares demanded through the first tier of the offer,
$T_1 = (T_1 - P_M)/P_M$,
$T_2 = (T_2 - P_M)/P_M$, and
P_M = pre-offer market price of target shares.

Most of the needed data is readily available. The tender offer price in any-or-all offers (P_T) and the first-tier price (T_1) in partial and two-tier offers is stated in the terms of the tender offer. The fraction of outstanding shares sought (F) is measured as the fraction of

[1] *Tender Offer Statistics, 1971–1983*, Douglas Austin & Associates, 3178 Republic Blvd. N., Suite 2, Toledo, Ohio 43615, 1984.

[2] In our study, we do not distinguish explicitly between "friendly" and "hostile" offers. In many cases, the target management has agreed to the bidding firm's offer terms. This is especially true in the case of two-tier offers when the second-tier terms are stated at the time of the first-tier offer.

[3] For our study, we augment the Austin data base with more detailed information from the *Wall Street Journal*. In a few cases it was necessary to eliminate a tender offer from our sample due to lack of contemporaneous price information about the target firm. Tender offers were also excluded if they were clean-up offers after the bidder had already obtained control of the firm. A list of excluded offers is available upon request.

Mergers, as opposed to tender offers, are specifically excluded from our sample. For example, in the complicated Martin Marietta/Bendix case, we include only the various tender offers in which shares were purchased. These offers include Martin Marietta's offer for Bendix and Bendix's offer for Martin Marietta. United Technologies friendly tender offer for Martin Marietta is not included because no shares were purchased under it and Allied's merger with Bendix is also excluded since no tender offer was involved.

outstanding shares purchased in the first round of the tender offer. The pre-offer market price of the target shares (P_M) is measured 20 trading days before the announcement of the initial offer of the contest. This earlier price is used to lower the probability that leakage of information about an impending tender offer has raised P_M above its value in the case of no tender offer.

The second-tier or clean-up price (T_2) is more difficult to determine. In cases where the second-tier offer is composed of securities, the actual security value may not equal that stated by the bidder. In implicit two-tier offers, the value of T_2 is not known until the second-tier offer is made. In pure partial offers, the second-tier price is essentially the post-offer trading price of the target shares. For uniformity in comparing these offers, we estimate T_2 in each type of offer as the market price of target shares 20 trading days after the execution of the initial offer.[4]

III. Why Bidders Use Partial and Two-Tier Tender Offers

The formula for the blended premium of a partial or two-tier offer can be used to show that any partial offer has a matching any-or-all offer in which target shareholders receive the algebraically equivalent premium. For example, a two-tier offer of $20 for 50 percent of the outstanding shares and $10 for the other 50 percent is algebraically equivalent to a uniform offer of $15 for any-or-all shares outstanding. The premium of the any-or-all offer equals the blended premium of the two-tier bid. Total outlay to the acquiring firm is equal under these bids assuming both induce 100 percent tenders. What are the economic differences, then, between partial and two-tier offers and any-or-all offers, and why are partial or two-tier tender offers preferred by some bidders? Several explanations have been suggested:

1. A partial tender offer leaves outstanding a minority equity interest in the target firm with the value of the outstanding shares determined in a competitive exchange market. In its report, the SEC Advisory Committee on Tender Offers cites several benefits of partial offers in addition to those listed below.[5]

2. The acquirer wishes to limit the financial risk of the takeover bid. An any-or-all tender offer exposes the bidder to finanical risk because it is difficult to predict with precision how many shares will be tendered in response to a particular offer. The total outlay required to obtain control depends on the offer price and the number of shares purchased. Because the bidder must choose the offer price before he knows the number of shares tendered, and because an any-or-all offer requires the bidder to purchase all tendered shares as long as the minimum conditions are met, the total outlay for the bidder seeking control cannot be known precisely in advance.

In contrast, a partial tender offer obligates the bidder to purchase only up to a pre-set maximum number of shares regardless of how many shares are tendered, as long as the minimum conditions are met. The partial offer sets an upper bound on the total outlay required for control and eliminates this source of financial risk to the bidder.[6]

3. A two-tier offer can increase the incentive for target shareholders to tender by offering a high first-tier premium and a relatively low second-tier premium. The greater the difference between the first-tier premium and the second-tier premium, the greater is the opportunity cost to target shareholders of not tendering if the offer succeeds. Under certain conditions, target shareholders can be induced to tender into a two-tier offer even though its blended premium is less than the uniform premium of an alternative any-or-all offer that is forthcoming. As identified by Professor Bradley, this situation is analogous to the classic prisoner's dilemma.[7]

The prisoner's dilemma analysis as applied to two-tier tender offers is clearer with an example. Suppose a target firm with 1,000 outstanding shares has a market value of $10 per share before the tender offer, for a total equity value of $10,000. Assume that a bidder is willing to pay $5,000 above this market value for control of the target firm. Therefore, the bidder is willing to pay $15 per-share in an any-or-all offer. Let us further assume that there is a strong expectation that in the near future (say 50 days) another bidder will offer $18 per share through an any-or-all offer.

Despite the expectation of a higher offer in the near future, the first bidder can fashion a two-tier offer to pressure target shareholders into responding while still paying only a $5,000 premium. Specifically, the first bidder offers $20 per-share for 500 shares on a proration basis, and $10 per share for the other 500 shares, to be paid after the first offer is executed. The blended price is $15, which equals the outlay in an any-or-all offer of $15 per share.

Faced with this offer, each target shareholder will reason that: (i) If other shareholders tender, then I should tender to avoid receiving only $10 for my shares; (ii) if other shareholders hold, then I should tender to receive the first-tier price of $20 per-share, with little prorationing risk if the offer succeeds. This reasoning will lead rational shareholders to tender. The result holds even though all shareholders know that concerted, organized refusal to tender would be the best strategy since it would allow by assumption all to receive $18 per share in the near future from an alternative bidder. The prisoner's dilemma that is created by the two-tier offer causes the shareholders to accept the lower-valued offer having a $15 blended price.

We studied all control contests involving partial or two-tier offers in 1981, 1982 and 1983 for evidence that any-or-all offers are disadvantaged relative to partial or two-tier offers in contests or that shareholders may be accepting a lower return by approving a partial or two-tier offer. As detailed in section V, there are no cases which support the suggestion that two-tier or partial offers can defeat competing any-or-all offers while providing lower premiums to target shareholders. Thus, though theoretically a two-tier offer can force the acceptance of a lower-valued offer, we find no cases where this actually happened.

4. Under SEC regulations in effect before December 15, 1982, a two-tier or partial tender offer forced shareholders to commit to tender their shares earlier

[4] In the case of exchange offers, it is especially important to use the market value of the target stock rather than the stated value of the securities offered. Shareholders will base their decisions on the market value of the securities, not the value as stated by the bidder.

[5] SEC Advisory Committee on Tender Offers, *Report of Recommendations*, July 8, 1983, pp. 24–25.

[6] Uncertainty about how many shares will be tendered in response to an any-or-all offer can create considerable risk. For example, the total outlay for control doubles if 100 percent of outstanding shares are tendered compared with 50 percent. In view of the large per share premiums offered and the large investments represented by many tender offers the incentive can be great for the bidder to put a ceiling on the total outlay required by the tender offer.

[7] Michael Bradley, "Interfirm Tender Offers and the Market for Corporate Control," *Journal of Business*, 1980, pp. 345–376. See especially pp. 355–356. The prisoner's dilemma is created by placing two suspected perpetrators of a crime in separate rooms and presenting each with the following proposition. If you confess and your partner does not, he receives the harshest punishment and you go free. If he confesses and you do not, then you receive the harshest punishment and he goes free. If both confess, then both receive moderate punishment. The rational prisoner will confess to avoid the harshest punishment, even though no confession results in both going free.

than they would under an any-or-all tender offer. This incentive resulted from the SEC's increase in the minimum offer period from 10 calendar days to 20 business days in 1979. At the same time, the minimum period for the proration pool remained at 10 calendar days. Therefore, while an any-or-all offer gave target shareholders 20 business days to make their tendering decisions, the partial or two-tier offer forced target shareholders to decide within 10 calendar days or forfeit their right to prorata acceptance of their tendered shares.

Earlier commitments by target shareholders benefit the bidding firm because target shareholders have less time to consider alternatives or wait for additional offers. This advantage to bidders of prorated offers have been eliminated since December 15, 1982, when the SEC extended proration rights throughout the offering period. We measure a moderate reduction in the incidence of two-tier and partial tender offers relative to any-or-all offers following this rule change.

IV. Empirical Results

A. Frequency of Tender Offers

Table 1 presents a breakdown by year and type of 148 tender offers in 1981, 1982 and 1983. There are 91 any-or-all offers accounting for 61 percent of the total. There are 57 partial and two-tier offers accounting for the remaining 39 percent. The relative incidence of any-or-all offers is roughly constant across the three years, with a modest increase ot 66.7 percent of the total in 1983. Two-tier and partial tender offers accounts for at least one-third of the total in each of the three years.

B. Size of Target Firms

Table 2 reports the average size of target firms by type of tender offer. Any-or-all offers are used generally for smaller target firms than either two-tier or pure partial offers. Target firms of any-or-all offers average $113.7 million in total equity value, as measured using the pre-contest stock price times the fully diluted number of shares. In contrast, targets of two-tier offers average $631 million and targets of pure partial offers average $353.8 million.

Tables 3a, 3b and 3c provide more detailed information on the distribution of target size by type of offer. Table 3a shows the absolute distribution of target size by type of offer and Table 3b reports the relative distribution of the same information. These tables reveal that 87.5 percent of two-tier offers and 60 percent of pure partial offers are for target firms of more than $40 million in equity value. On the other hand, only 46.2 percent of any-or-all offers are for these larger firms.

Table 3c reports the percentage of each type of offer in each class of target size. As the size of the target firm increases, two-tier and pure partial offers become increasingly prevalent and any-or-all offers play a lesser role. For target firms with less than $5 million in equity value, 93 percent of the 14 tender offers made are any-or-all offers. For the very largest firms (more than $320 million in equity value), only 25 percent of the 20 offers are any-or-all offers, while 75 percent are two-tier and pure partial tender offers. Clearly, two-tier and pure partial tender offers play an important role in takeover contests for medium-sized and large targets while any-or-all offers are used mainly for smaller targets.

C. Premiums in Tender Offers

1. *Any-or-All and Blended Premium.* The any-or-all and blended premiums for the three different types of tender offers are compared by year in Table 4. The three year average show that the mean premiums for any-or-all offers is highest at 83.4 percent, compared with a moderately lower blended premium of 55.1 percent for two-tier offers. Partial offers yield a much lower blended premium of 31.3 percent.

Through the average premium for any-or-all offers is higher than the average blended premium for two-tier offers, a closer look at the distribution of premiums (Tables 5a and 5b) reveals the similarity between the magnitude of any-or-all and two-tier premiums. For example, 72 percent of two-tier blended premiums are greater than 40 percent while 68 percent of the any-or-all offers exceed 40 percent premiums. Therefore, we do not find a substantial difference between any-or-all premiums and blended two-tier premiums.

2. *Bid Premiums.* The bid premium is defined as the overall premium in any-or-all offers and the first-tier premium for tow-tier and partial offers. As shown in Table 6, the bid premium is virtually identical for any-or-all and two-tier offers at 63 percent. The pure partial offer premium is 45.9 percent. Referring back to blended premiums, it is clear that the blended premiums in two-tier and pure partial offers are less than the corresponding bid premiums. Clearly, the generally lower second-tier price pulls down the blended premium, especially for partial offers.

3. *First-Tier and Second-Tier Premiums.* Table 7 divides the blended premiums of two-tier and pure partial offers into its components—the first-tier and second-tier premiums. In every year the mean second-tier premium is positive for both two-tier and for pure partial offers, indicating that the market value of the second tier generally exceeds the pre-offer market price of the target. The average second-tier premium is 47.1 percent for two-tier offers and 18.6 percent for pure partial offers. These second-tier premiums are clearly substantial on average.[8]

Table 8 reports data on the difference in magnitude between first-tier and second-tier premiums. This computation addresses the concern that target shareholders are induced to tender to two-tier and partial offers because of large differences between the values of the two tiers. The first-tier premium is 14.5 percent larger than the second-tier premium for two-tier offers on average. For partial offers, the first-tier premium is 28.7 percent larger than the second-tier premium on average. In two-tier offers, this difference between the value of the two tiers is not very large, especially when compared to the difference in pure partial offers.

Table 8 provides a detailed breakdown of the relative difference between the value of the two tiers in two-tier and pure partial offers. The second-tier premium is no more than 20 percent less than the first-tier premium for 72 percent of the two-tier offers. For partial offers, the second-tier premium is no more than 20 percent less than the first-tier premium in 48 percent of the cases.

V. Multiple Bidder Contests

We survey the outcomes of multiple-bidder contests for corporate control between 1981 and 1983 with a view toward the question of whether partial or two-tier offers have an unfair advantage vis-a-vis other kinds of offers. Table 9 lists a total of 26 contests, in alphabetical order of the target firm's name. This table accounts for all multiple-bidder control contests between 1981 and 1983 in which at least one offer was a partial or two-tier tender offer.[9] There are a total of 62

[8] The second-tier price of target shares has not been purged of overall market trends. T_2 will more accurately reflect changes in share value due strictly to the tender offer when the market model is used to extract out overall market influences.

[9] There is one notable control case which is not included in this taole—the Bendix case. There were two tender offers simultaneously on the table in that contest. United Technologies made a formal tender offer for Bendix which was exactly the same as the Martin Marietta bid in terms of percent sought and price per share. However, it was made as a fallback bid rather than as a competing bid despite the fact that its effective date was only eight days later than the Martin Marietta withdrawal date. The United Technologies offer was specifically designed so as not to lure any shares away from the Martin Marietta proration pool, i.e., so as not to compete.

bidders, for an average of 2.4 bidders per target. Seventeen of these bidders (27 percent) made any-or-all offers. For these purposes, we count a merger proposal that treats all shareholders equally as an any-or-all bid even if part or all of the consideration involves securities of the bidder. We are interested in cases that force shareholders to choose between a partial or a two-tier tender offer, on the one hand, and a uniform-bid tender offer or merger that does not involve pro-rationing, on the other hand. Therefore, we identify those cases in which partial or two-tier offers are subscribed to by target shareholders despite the availability of a more lucrative uniform-bid merger proposal or any-or-all tender offer.

Table 9 highlights such cases by the indication of a "No" response to the column (4) question "Winner Was Any-or-All?", and a "No" response to the column (5) question "Offer with Highest Value Won?" Of the 16 targets that received at least one any-or-all offer, the any-or-all bid loses to a competing partial or two-tier tender offer in only four cases. In three of these cases, it is clear that the rejected any-or-all bid provided less overall compensation to target shareholders than did the competing tender offer. In the remaining case (Conoco), what appears to be the best offer (Mobil's any-or-all bid) was rendered ineffective by the Justice Department's preliminary injunction. Therefore, the any-or-all offer did not have to be topped by the competing bidders.

This investigation of control contests occurring between 1981 and 1983 produces no case supporting the hypothesis that a two-tier or partial tender offer, because of its potentially coercive nature, can dominate a competing any-or-all tender offer or merger bid without offering greater overall compensation. The evidence is that: (i) 12 of 16 head-to-head contests between any-or-all and partial of two-tier offers are won by any-or-all bids, (ii) in three of the four exceptions, the partial or two-tier bid clearly offered greater compensation, and (iii) in the remaining case (Conoco), the losing any-or-all bid, although apparently higher-valued, was ineffective because of antitrust opposition.

VI. Conclusion

This study of 148 tender offers between 1981 and 1983 has several noteworthy results. In general, any-or-all offers are more frequent than partial and two-tier offers, with the former accounting for 91 of the total 148 offers. However, the incidence of any-or-all offers is much higher among smaller targets, while partial and two-tier offers predominate among moderate and large targets. This empirical regularity may reflect an underlying economic difference between any-or-all and two-tier or partial offers, with the latter types favored by bidders for relatively large targets. This implies that any regulatory disincentives currently under consideration to partial and two-tier offers may have more important effects for larger takeover targets than smaller targets.

We present detailed comparisons of uniform premiums in any-or-all offers with blended premiums in two-tier and partial offers. The average premium for the 91 any-or-all offers is highest at 53.4 percent relative to the pre-offer market price. (Note that this is for generally smaller targets.) The 32 two-tier offers yield an average blended premium of 55.1 percent, while the 25 pure partial offers yield 31.3 percent. Any-or-all premiums and two-tier blended premiums are very similar in magnitude—72 percent of two-tier premiums exceed 40 percent while 68 percent of any-or-all premiums do so.

The two-tier offer yields an average first-tier premium of 53.5 percent, virtually identical to the average uniform premium for any-or-all offers. The average second-tier premium of 47.1 percent for two-tier offers is less than the first-tier premium, but it is considerably larger than the "implicit" second-tier premium of 18.6 percent afforded by the 25 partial tender offers. Indeed, the average second-tier premium for two-tier offers (47.1 percent) exceeds the average blended premium for pure partial offers (45.9 percent). Therefore, two-tier "blended" offers are nearly as beneficial to target shareholders as any-or-all offers, and two-tier offers are significantly more beneficial than pure partial offers which have no second-tier purchases by the bidders.

The study also investigates the relative differences between first-tier and second-tier premiums for two-tier and partial tender offers. Nearly three-fourths of the 32 two-tier offers have less than a 20 percent difference between the first and second-tier premiums. In contrast, less than half of the 25 pure partial offers have less than a 20 percent difference between the first- and second-tier premiums. Therefore, while the second tier of a two-tier offer generally provides a lower premium than does the first-tier, the difference in magnitude between the two premiums is not large, especially when compared to pure partial offers. The average first-tier premium is 14.5 percent larger than the second-tier premium for two-tier offers, while it is 28.7 percent larger than the implicit second-tier premium in pure partial offers.

In view of these results, it probably would not be beneficial to adopt regulatory changes which would encourage the use of partial tender offers instead of two-tier offers. The second-tier premium in two-tier offers is on average twice as large as the implicit second-tier value in partial offers. Any substitution of partial offers for two-tier offers would deprive target shareholders of this greater return.

Also, these results suggest that it is problematic whether target shareholders would benefit from regulatory inducements to use any-or-all instead of two-tier offers. First, such a switch increases the returns to target shareholders only modestly, since any-or-all premiums on average exceed the blended premiums for two-tier offers by a relatively small margin. Second, in veiw of this data it is likely that forcing the use of any-or-all offers will deter some takeovers, especially of larger targets. The losses to target shareholders from such foregone transactions, even if they are few, can outweigh the benefits of higher any-or-all premiums. This conclusion is strengthened by the expectation that shareholders of large targets are the likely losers in deterred transactions and these large transactions account for much of the dollar gains to target shareholders.

Although it is necessary for policymakers to consider carefully the possible deterrence effects of proposed regulatory changes, the data required for the task is not complete. Specifically, this study does not measure the returns to the acquiring firms so we can only speculate about how regulatory changes such as increased minimum offer periods will reduce takeover activity. Since deterrence effects can have important consequences for shareholder welfare, it is a critical consideration. It is our intention to pursue research that will help one understand better the deterrence effects of takeover regulations.

A second caveat to keep in mind is that the study does not (as yet) utilize the market model of finance to purge the data of the effects of general market movements. This adjustment for market-wide movements in stock prices is especially needed in the computation of the second-tier premiums, which equal the percentage change of the stock price twenty days after the close of the first-tier offer relative to the market price of

the target twenty days before the first offer. These two prices are separated by a few months, during which time the changes in the general level of stock prices could cause these two prices to change significantly. Ignoring the adjustment for general market movements should not greatly affect the overall averages, but it can make important differences in certain cases. Therefore, we are currently in the process of statistically adjusting the value of the second-tier premiums to abstract from general market movements.

A final caveat is that the sample includes only 1981, 1982 and 1983 tender offers. It is desirable to enlarge this sample by including offers over a longer period of time. Future research will incorporate tender offers from the 1970s as well as 1980.

TABLE 1.—NUMBER OF TENDER OFFERS, BY TYPE AND YEAR, 1981–83

[Type of tender offer]

Year	Any-or-all[1]	Two-tier[2]	Pure partial[3]
1981	37	12	15
1982	32	12	7
1983	22	8	3
Total	91	32	25

[1] Any-or-all offers are for all tendered shares, as long as minimum conditions are met.
[2] In two-tier offers, the offer for shares is in two steps. In an explicit two-tier offer, the bidding firm agrees at the time of the initial offer with target management to purchase the remaining shares following the execution of the first-tier partial offer. In implicit two-tier offers, a second tier is revealed shortly after the execution of the tender offer.
[3] Pure partial offers are for less than all shares. There is no clean-up merger or tender offer closely following the execution of the tender offer.

Source: *Tender Offer Statistics, 1971–1983*, Douglas Austin & Associates Inc., 1984 and the *Wall Street Journal*.

TABLE 2.—AVERAGE SIZE[1] OF TARGETS, BY TYPE OF TENDER OFFER AND YEAR, 1981–83

[Type of tender offer—in millions of dollars]

Year	Any-or-All	Two-tier	Pure partial
1981	125.6	965.4	517.2
1982	67.9	581.2	119.8
1983	160.2	204.2	192.6
Total	113.7	631.0	353.8

[1] Size is measured as the market value of target's equity. It is computed as the number of fully diluted common shares multiplied by the pre-offer market price of those shares.

TABLE 3A.—ABSOLUTE DISTRIBUTION OF TARGET SIZE, BY TYPE OF TENDER OFFER, 1981–83

[Type of tender offer]

Range of target size (in dollars)	Any-or-all	Two-tier	Pure partial
Less than 5m	13	0	1
5m to 10m	11	1	2
10m to 20m	9	1	6
20m to 40m	16	2	1
40m to 80m	12	7	5
80m to 160m	11	2	3
160m to 320m	14	9	2
Greater than 320m	5	10	5
Total	91	32	25

TABLE 3b.—RELATIVE DISTRIBUTION OF TARGET SIZE, BY TYPE OF TENDER OFFER, 1981–83

[Type of tender offer—in percentages]

Range of target size (in dollars)	Any-or-all	Two-tier	Pure partial
Less than 5m	14.3	0.0	4.0
5m to 10m	12.1	3.1	8.0
10m to 20m	9.9	3.1	24.0
20m to 40m	17.6	6.3	4.0
40m to 80m	13.2	21.9	20.0
80m to 160m	12.1	6.3	12.0
160m to 320m	15.4	28.1	8.0
Greater than 320m	5.5	31.2	20.0
Total	100.0	100.0	100.0

TABLE 3c.—PERCENTAGE OF TENDER OFFERS ACCOUNTED FOR BY EACH TYPE OF OFFER, BY TARGET SIZE, 1981–83

[Type of tender offer]

Range of target size (in dollars)	Any-or-all	Two-tier	Pure partial
Less than 5m	92.9	0.0	7.2
5m to 10m	78.6	7.2	14.2
10m to 20m	58.2	6.2	37.5
20m to 40m	84.2	10.5	5.3
40m to 80m	50.0	29.2	20.8
80m to 160m	68.8	12.5	18.7
160m to 320m	56.0	36.0	8.0
Greater than 320m	29.0	50.0	25.0

TABLE 4.—AVERAGE PERCENT PREMIUMS FOR ANY-OR-ALL OFFERS,[1] AND PERCENT BLENDED PREMIUMS FOR TWO-TIER AND PARTIAL OFFERS,[2] BY YEAR, 1981–83

[Type of tender offer]

Year	Any-or-all	Two-Tier	Pure partial
1981	66.2	55.4	15.4
1982	70.7	47.3	37.5
1983	49.6	66.4	49.4
Total	63.4	55.1	31.3

[1] The any-or-all offer premium equals: $P_A = (P_T - P_{pre})/P_{pre}$.
[2] The blended offer premium equals: $P_B = (F \times T_1) + ((1-P) \times T_2)$.

TABLE 5A.—ABSOLUTE DISTRIBUTION OF ANY-OR-ALL PREMIUMS AND BLENDED PREMIUMS, BY TYPE, 1981–83

[Type of tender offer]

Range of percent premium	Any-or-all	Two-tier	Pure partial
Less than 0	3	1	2
0 to 20	12	2	9
20 to 40	11	9	7
40 to 60	21	14	4
60 to 80	16	6	0
80 to 100	12	2	2
100 to 120	9	0	1
Greater than 120	7	1	0
Total	91	32	25

TABLE 5b.—RELATIVE DISTRIBUTION OF PREMIUMS AND BLENDED PREMIUMS, BY TYPE OF TENDER OFFER, 1981–83

[Type of tender offer—in percentages]

Range of percent premium	Any-or-all	Two-tier	Pure partial
Less than 0	3.3	3.1	8.0
0 to 20	13.2	6.2	36.0
20 to 40	12.1	19.8	28.0
40 to 60	23.1	43.8	16.0
60 to 80	17.6	18.8	0.0
80 to 100	13.2	6.2	8.0
100 to 120	9.9	0	4.0
Greater than 120	7.7	3.1	0.0
Total	100	100	100

TABLE 6.—AVERAGE PERCENT BID PREMIUMS[1], BY TYPE AND YEAR, 1981–83

[Type of tender offer]

Year	Any-or-all	Two-tier	Pure partial
1981	66.2	66.0	30.2
1982	70.7	51.8	72.9
1983	49.6	73.2	61.8
Total	63.4	60.6	46.9

[1] The bid premium is the overall premium in any-or-all offers and the first-tier premium in two-tier and pure partial offers.

TABLE 7.—FIRST- AND SECOND-TIER PREMIUMS IN TWO-TIER AND PURE PARTIAL OFFERS, 1981–83

Year	Two-tier			Pure partial		
	First tier	Second tier	Blended premium	First tier	Second tier	Blended premium
1981	69.0	41.8	55.4	30.2	8.5	15.4
1982	51.8	46.4	47.3	72.9	30.3	37.5
1983	73.2	56.4	66.4	61.8	41.9	49.4
Total	60.5	47.1	55.1	46.9	18.6	31.3

TABLE 8.—ABSOLUTE AND RELATIVE FREQUENCIES OF PERCENT DIFFERENCES BETWEEN FIRST- AND SECOND-TIER VALUES,[1] FOR TWO-TIER AND PARTIAL TENDER OFFERS, 1982–1983[2]

Range of percent difference in tiers	Absolute frequency		Relative frequency	
	Two-tier	Partial	Two-tier	Partial
Less than 0	7	6	21.9	24.0
0 to 10	10	5	31.3	20.0
10 to 20	6	1	18.8	4.0
20 to 30	2	3	6.2	12.0
30 to 40	1	1	3.1	4.0
40 to 50	4	4	12.5	16.0
50 to 60	0	1	0.0	4.0
60 to 70	1	1	3.1	4.0
70 to 80	0	1	0.0	0.0
80 to 90	0	0	0.0	0.0
90 to 100	0	0	0.0	0.0
Greater than 100	1	2	3.1	8.0
Total	32	25	100	100

[1] The percent difference in tier values equals: $(T_1 - T_2)/T_2 \times 100$.
[2] The mean percent difference between first- and second-tier values is 14.5 percent for two-tier offers and 28.7 percent for pure partial offers.

TABLE 9.—TENDER OFFER AUCTION CONTESTS FOR CONTROL 1981–83

(1) Target	(2) No. of bidders	(3) No. of any-or-all bidders	(4) Winner was any-or-all?	(5) Offer with highest value won?	(6) Reason if (5) is "No"
Brookwood Health	2	2	Yes	Yes	
Brunswick	2	0	No	Yes	
Buffalo Forge	2	1	Yes	Yes	
Cities Service	3	0	No	No	July 29, 1982, FTC authorized the issuance of a preliminary injunction of Gulf acquisition. Gulf then abandoned its bid.
Conoco	4	1	No	No	In Nov. of 1981 the Justice Dept issued a preliminary injunction against a Mobil Corp. Acquisition of Conoco.
Fisher Scientific Corp [1]	2	1	No	Yes	
General American Oil	3	1	Yes	Yes	
General Steel Industries [2]	2	1	Yes	Yes	
Gray Drug Stores	2	1	Yes	Yes	
HMW Industries	2	1	No	Yes	
Interpace	2	1	No	Yes	
Lightolier	2	0	No	Yes	
Manufacturers Bancorp	2	0	No	Yes	
Marathon	3	0	No	Yes	
Means Services, Inc.	2	0	No	Yes	
National Mine Service	2	0	No	Yes	
Norton Simon	3	0	No	Yes	
Petrie	4	0	No	Yes	
Property Investors of Colorado	2	1	Yes	Yes	
Richardson	2	1	Yes	Yes	
Standard Coosa Thatcher	2	1	Yes	Yes	
St. Joe Minerals	2	1	Yes	Yes	
Stokely Van Camp	3	1	Yes	Yes	
Suncoem	2	0	No	Yes	
Texas Gas Resources	2	1	Yes	Yes	
Union Commerce	3	1	Yes	(3)	

[1] This is nominally a contest. In April of 1981 a merger proposal was turned down by management. This offer was never made to shareholders. Then in July, when the first offer was long gone, a successful partial tender offer was launched by another firm. The partial offer won, however, it was clearly the better offer.
[2] This is another case where an any-or-all beats a partial. However, it should be pointed out that the partial bid ran into legal problems because of prior open market purchases.
[3] In this case Central Bancorp had the highest per share price on its partial offer. However, it lost to Huntington Bankshares' any-or-all offer when the Federal Reserve blocked Central's bid. Since we don't know what Central Bancorp's second tier would have been, and since the offers were otherwise close, it is difficult to determine whether the best offer won.

[FR Doc. 84-17308 Filed 6-28-84; 8:45 am]
BILLING CODE 8010-01-M

PROPOSAL TO EXTEND OFFERING PERIOD

Chairman SHAD. The first proposal is Senator Metzenbaum's proposal to extend the minimum offering period for tender offers from 20 business days to 60 calendar days. Now, 20 business days equates to about 28 calendar days.

The Commission opposes this proposal because an extension is not necessary for shareholder protection. The Tender Offer Advisory Committee considered the offering period during its February-July 1983 deliberations and the Commission has subsequently considered it.

Both have concluded that an extension of the offering period is not necessary for shareholder protection and that it would be inconsistent with the objectives of the Williams Act to maintain legislative and regulatory neutrality between bidder and target companies.

The current 20-business-day minimum offering period is the product of extensive deliberations and public comments. It comes out of hearings, SEC solicitation of public comments, and a rulemaking release in 1979; and it has been reconsidered and reviewed a number of times since then.

The rules already require a 10-business-day extension if the price of a tender offer is increased, which often occurs. So you have the 20 business days plus a possible additional 10 that together totals up to 42 calendar days if the extension comes at the end of the first 20-day period.

So when Senator Metzenbaum suggested something may be less than 60, well, we do have standards now that total up to about 42 days put end to end.

Shareholder complaints over the adequacy of the time have been negligible. There were complaints before we extended the proration period for the length of the offering period in December 1982. But

now, since that proration period extension occurred, there have been negligible shareholder complaints over the adequacy of the minimum offering period.

In all prior relevant legislation and regulations—the Williams Act, the Hart-Scott-Rodino Antitrust Improvements Act, and the SEC's tender offer regulations—the Congress and the Commission have consistently enunciated a policy of neutrality between bidder and target companies. The Congress and the Commission have stated that lengthy delays might discourage tender offers' chances for success.

So those are the reasons we oppose the extension of the 20-business-day period.

Senator D'AMATO. Let me ask you something. Suppose we said 30 business days. Would you feel violently opposed to that?

Chairman SHAD. Yes, we would.

Senator D'AMATO. Why?

Chairman SHAD. Because it is longer than you need. It is 50 percent longer.

Senator D'AMATO. What violence would it do if, for example—I get into the area of some kind of practicality in these things. If there are certain of our colleagues—there are Senators who feel it may not be adequate notice to some elderly people to come back, and by the time they are due it is too late.

What disadvantage would it place those companies who make the offer or those people who make the offers if, for example, we were to extend it 10 additional days?

Chairman SHAD. The consequence of a 50-percent extension of the time period would put a greater risk on the bidder. It would inhibit first bids. That was acknowledged, as a matter of fact, in the House bill—the House committee report on the bill just passed. They didn't argue that shareholders needed the time—that they needed the protection, but rather it would give management of the target companies more time to defend. When you set up that circumstance, you inhibit the bid in the first place, and you give greater odds against it succeeding in the second place. As a matter of fact, there have been very few contested tender offers that have been successful. They usually get stopped.

Senator D'AMATO. Mr. Chairman, now you have placed a reason for your opposition in the record.

Chairman SHAD. I think so.

Thank you.

Senator METZENBAUM. Would you explain again how you get it up to 42 days?

Chairman SHAD. Yes; 20 business days, figuring 5 days plus weekends—is approximately 28 calendar days, it can be even more than 28. And 20 business days ranges from a period of 26 calendar to as long as 32 calendar days, depending on intervening weekends and national holidays. The average is about 28.

So the basic rule itself requires 20 business days. You propose 60 calendar days.

In addition, within the rule if there is an increase in the price, there is a provision that automatically requires a 10-day business extension.

Senator METZENBAUM. You say if there is an extension. But the normal tender offer.

Chairman SHAD. Many tender offers include an extension because of price changes.

Senator METZENBAUM. Most of them have price changes?

Chairman SHAD. Well, I don't want to say categorically that most tender offers are extended.

Senator METZENBAUM. The most you have is 28 days?

Chairman SHAD. 28 calendar days on average.

Senator METZENBAUM. So the Chairman is asking you what would be so bad about increasing that 20 days, and you are worried about the offeror.

Isn't your principal responsibility to the shareholders generally, not to the offeror who is trying to take over?

Chairman SHAD. Oh, absolutely. And we are convinced it is not justified by shareholder protection requirements, unless more shareholders requested it.

I would like to go on because I am going to point out why a high percentage of shareholders participate in the first tier of two-tier tender offers. The concern, of course, is that they are not getting a chance to participate. The facts are to the contrary. A very high percentage are participating, and I will amplify that in just a second.

Senator METZENBAUM. I didn't mean to interrupt.

Senator D'AMATO. Would you proceed?

SECOND PROPOSAL—20 PERCENT OWNERSHIP TENDER OFFER

Chairman SHAD. The next item I had was a proposal by Senator Specter to require that if a tender offer results in ownership of over 20 percent of a company's shares, a cash offer must be made to all the shareholders for all the shares. This is a modification of Senator Metzenbaum's proposal which didn't include for all the shares. But, putting the two together, the SEC is sensitive to the concerns of those who believe that two-tier and partial tender offers are coercive. The Commission is therefore soliciting public comment and conducting an extensive analysis of the issues raised by such offers.

Those who believe that two-tier and partials serve valid business purposes cite the following facts:

Some have the impression that few public investors participate in the high front end premiums in two-tier tender offers. However, in successful 1983-84 two-tier tenders for over 50 percent of the target company shares, the holders of over 87 percent of the shares participated in the first step—the high front end step. The 13 percent who did not participate would include those who opposed the offers, restrictive trusts, and foreign and other investors who seldom respond to shareholder communications.

Partial tender offers diversified investment in many companies instead of a large investment in a single company, technological exchanges between companies when they engage in partial acquisitions of each other and getting to know a company before increasing one's investment.

A study of 148 tender offers in 1981 through 1983 by the Commission's Office of the Chief Economist, an exhibit to the Commission's written testimony, demonstrates that shareholders have received substantially greater premiums over the market prices of their shares in two-tier tender offers than in partial tender offers. In both any-and-all tender offers and the first step of a two-tier tender offer, shareholders have received about the same average premium—63 percent—and, Senator Metzenbaum and——

Senator D'AMATO. Will you continue to make your point. But, believe me, Senator Metzenbaum will engage you sooner than you might want. [Laughter.]

Chairman SHAD. I'm sure of that. There was a factual inaccuracy. I just had mentioned a number which was contrary to something you had said. It is the first tier premium average, which is actually 64 percent, and two-tier tender, not 69 but also——

Senator METZENBAUM. I accept the correction.

Chairman SHAD. Also, I was just noting that it works out to substantially the same premium on any-and-all tenders—64 percent. Sixty-three and a fraction percent on any and all and on the first tier of a two-tier, 64-percent average. And the second tier of a two-tier, they have averaged 47 percent, which brings a blended average for two tier to 55 percent as compared with a 31-percent blended average premium in partial tender offers—a 24-percent difference, which is enormous.

The point I'm trying to make is that two-tier tender offers are much more attractive to investors than partials. The Chief Economist's study also demonstrates that two-tier and partial tender offers have been used to acquire interests in much larger companies than in all-or-any tender offers.

The average size of the company acquired through a two-tier tender is over five times as large as the average company acquired through an any-and-all tender offer. For an any-and-all, you've got to have a lot of dough on the table to go for a major company, and you're not even sure you're going to get it. So that's one of the reasons you have a much larger size average company being tendered for either under partials or a two-tier and than under any-and-alls.

Senator LAUTENBERG. That has to do with the ability to control as well. You don't need anywhere near as large an entity to exercise substantial control.

Chairman SHAD. Surely.

Senator METZENBAUM. I'm not sure I get the final point you are making. I recognize that as a fact but——

Chairman SHAD. Let me make the final point in the next statement which is, whether good or bad, if partial and two-tier tenders are proscribed as proposed, it can be expected to reduce larger corporations' exposures to tender offers. If that's your purpose, why that's the result that's most probable. It should also be noted that over the past 3 years there has been a steady decline in the number of two-tier tender offers from 32 fiscal 1982 to 15 in fiscal 1984, which just ended in September.

As a percentage of all tender offers, two-tiers have declined from 27 percent in fiscal 1982 to only 13 percent in fiscal year just ended, fiscal 1984.

Also, as I mentioned at the outset, last June, the Commission distributed a release soliciting public comment on the concerns over two-tier and the partial tender offers. Also, four alternative approaches were suggested and comment requested. Those alternatives are the approach of Senators Metzenbaum and Specter—also the Tender Offer Advisory Committee approach, which would increase by 2 weeks the minimum offering period for two-tier and partial tender offers as a disincentive. The alternative has also been raised of making cash tender offers shorter. It is an incentive to do all-or-any cash tender offers.

The British approach was discussed, which permits the shareholders simultaneously to tender and vote for or against the tender offer. If it's defeated, the shares are returned.

And, finally, there is an approach which would require second offers within a specified time to be at least as attractive as the initial offer. Comments are being received on these alternatives and related issues.

The third proposal that has been discussed this afternoon was proposed by Senator Chafee. That would require——

Senator SPECTER. If I might interrupt you for just a moment, because I have another commitment. You have finished your testimony on the proposal for requiring a purchase if someone requires more than 20 percent?

The question I have for you relates to your procedures with respect to recommendations made by the Securities and Exchange Advisory Committee on tender offers. That suggestion was made back on June 10, 1983, and you are still soliciting comments about it?

Chairman SHAD. We asked for comments in June of this year, but we conducted a lot of discussion at the SEC, and participated in testimony in the House, on the same point; so that's the reason why 1 year has elapsed since that proposal. And, actually——

REASONS FOR DELAY IN FINAL REPORT

Senator SPECTER. Why does it take so long?

Chairman SHAD. Well, first of all, although it was approved in June, the final report of the advisory committee wasn't distributed until July. It was issued on July 8.

Senator SPECTER. A month later you're saying?

Chairman SHAD. A month later. We provided copies to all the members of the Senate Banking Committee and the House Committee. There were subsequent staff discussions between the SEC staff and the Hill staffs. Our staff has gone through an exhaustive type of review over this and other alternatives, and we concluded that, just as in the case of your proposal, we were not prepared to pick one against all others and make a flat endorsement of it until we had gotten a lot more information and statistical analysis of what has been happening in all of these tender offers to draw factual conclusions.

There have been statements made that there's an enormous disparity between first and second bids. Well, it's a very small disparity.

Senator SPECTER. Wait a minute. What was the factual basis, if you know, made by the advisory committee in coming to the conclusion that it did? Did it make an exhaustive study itself?

Chairman SHAD. Well, they didn't do an economic analysis, which the SEC has done. They didn't have these facts I laid out today.

Senator SPECTER. What facts did they have?

Chairman SHAD. I think that the 18-member advisory committee had the broadest experience of any group in the country—pragmatic experience doing these transactions—but not the total overview perspective of Congress and the SEC.

Senator SPECTER. When do you anticipate coming to a conclusion?

Chairman SHAD. The comments are coming in right now on the release we put out in June. They were supposed to have been in by September 14, but they are still coming. And we have not told the public not to submit their comments. I would expect by next month, by November, we could provide this committee or interested parties with a summary of those comments. But before we get to the point of making a considered recommendation to the Senate and the House, we are going to do a lot more analytical work on broad economic aspects that I have alluded to.

So, to give you a total summation, I would say early next year.

Senator SPECTER. Is there any way to expedite this process?

Here you have the Commission—the advisory committee studying at some length—I don't know precisely how long. Perhaps you do. They make a recommendation on June 10, 1983, and it sounds to me like it is going to be more than 2 years before——

Senator D'AMATO. Let me, if I might, suggest that I intend to chair a series of hearings on tender offers next year. I intend to thoroughly analyze this subject from beginning to end. The tactics employed have become counterproductive. I will move ahead.

Chairman SHAD. May I also add, to be fully responsive to Senator Specter, the SEC has proposed major legislation as a product of the advisory committee's work and our own work—independent analysis—that has been introduced to both the House and the Senate, and I am very pleased that the banking bill does incorporate almost verbatim the proposal by the Commission on greenmail and golden parachutes.

And there are other pieces to this legislation that we have submitted. So I don't want you to think we have just been doing nothing since June 10 of last year.

Senator SPECTER. Thank you, Chairman Shad. Thank you, Mr. Chairman.

Senator D'AMATO. We have a scheduling problem, and I wonder, Mr. Chairman, if you would suspend going forward. But we want you to stay here because we know that there are additional questions.

But Mr. Pickens has come from Texas to be with us and I understand he has to catch a plane to get back. They tell me he is attempting a takeover of Mobil Oil now. [Laughter.]

If he would join us, and, Mr. Chairman, if you would stay there, and we will get the picture in all the financial journals of America with you and Boone Pickens side by side. [Laughter.]

STATEMENT OF THOMAS BOONE PICKENS, JR., CHAIRMAN AND PRESIDENT, MESA PETROLEUM CO., AMARILLO, TX

Senator D'AMATO. Mr. Pickens, I thank you for taking your time to join us, so you will have an opportunity to make your observations with respect to the proposed legislation and other areas you might want to touch on.

Mr. PICKENS. I will make my remarks brief, Mr. Chairman. I have a statement for the record here which I will leave. It has already been passed out, and I appreciate the opportunity to comment today.

NEED OF DIRECTORS TO OWN SHARES

Senator Chafee and I have talked about the 1,000-share point that he is proposing, and I wish it were more than 1,000 shares.

Senator D'AMATO. You wish it were more?

Mr. PICKENS. Yes. I would like to see the director's fees be held up for a period until 1,000 shares are accumulated and then leave half of the director's fees till 2,000 shares are accumulated and leave 25 percent of the director's fee until 10,000 shares are accumulated.

Senator LAUTENBERG. How do they pay the tax on that? I mean, it is constructive receipt.

Mr. PICKENS. I say let them go ahead and pay the tax. Let's get them an investment, that is what I would like to see.

Senator LAUTENBERG. You pay to get on the board so you can have exposed liability?

Mr. PICKENS. Well, it makes the stock pretty cheap if all you are doing is paying tax on the director's fee.

Senator LAUTENBERG. Fifty cents on the dollar.

Mr. PICKENS. So you are getting 50 cents on the dollar for the stock.

I want to see these directors have an ownership position. I read so many proxy statements from time to time, as I know many of you do, too, and I see where certain of these directors have zero shares. I can't believe that. I would be embarrassed. I serve on a number of boards of directors—not as many today as I did 2 years ago—but I have served on a number of boards of directors, and I have always felt that it would be the smart thing to do and that I would feel comfortable with it to have a meaningful position in that company stock.

On other points—greenmail and golden parachutes—I think they fall in the same categories as the 1,000-share participation in the company ownership. I think they are all management points. I think they are good points.

I am opposed to greenmail. I am opposed to golden parachutes. Beyond that, I think the SEC has done a credible job of policing the other items.

I, too, have some problems with two-tier offers, but I think again those offers are almost a thing of the past. When I look back over them I see the same things that Chairman Shad did, that there isn't that great a discrepancy because a high percentage of stockholders do tender into the first offer.

We have never been involved in a two-tier offer. We have had an offer put on us by Cities Service where it was one of the most flagrant of all. I recall that the first step was $21 and the backside step was $9. So it doesn't feel very comfortable when that happens to you, but fortunately Gulf came in and made an offer for Cities Service and everything went away.

I see a tremendous opportunity in corporate America to straighten out some things by professional management. I think they are not accountable to stockholders. I think they feel they own the company, instead of the stockholders.

I think that is pointed out time after time by decisions that they do make that are not in behalf of stockholders. They will make the statement that we have turned the offer down because it wasn't in the best interest of the stockholders when in fact they own very little stock.

In a case of Gulf Oil, for instance, that management owned less than one-tenth of 1 percent of the company, well, the board of directors only owned less than three-tenths of 1 percent. The CEO of the company had been there 42 years, made a salary of over $1 million a year, and actually owned 21,000 shares of stock. He didn't own that until we started making speeches about it and he upped his ownership 29 percent from 17,000 to 21,000. That was the biggest increase he had ever made in his ownership of Gulf stock, after we started making speeches that the CEO doesn't own much stock.

I want to get that ownership in there. I want their risk to be the same as the stockholders' risk. I want them to cut out the perks that they continue to get from the stockholders. They take no risk and just proceed as they want to do.

GULF OIL DEAL

I want to comment about what Senator Specter was talking about the Gulf deal and what happened. I guess I am from the old-fashioned crowd, I do believe that stockholders are the owners of the company and managements are not. At Mesa Petroleum, I own stock in the company and am an employee of the company. I am an employee of the stockholders.

In the Gulf situation—let me quickly just take you back to some numbers. The all-time high for Gulf stock was reached in 1981 at $53. The company at the time we bought the first share was $37 and our offer was $65, which was not a cheap offer. It was a partial tender offer, but in this case we had no plan to make a second step inferior offer. That was never in our plan.

Then SoCal came in, now Chevron, and offered $80 a share. Now, remember, this stock was never higher than $53. So you are talking about at least a $40 per share increase in value for those stockholders, and you are talking about 165 million shares outstanding, with 400,000 stockholders. You are talking about a profit of $6.5 billion, which was not going to be realized by the Gulf management because the company was truly in liquidation. It had not replaced its domestic reserve base for 12 straight years.

At Gulf you had a company in liquidation, with profit available to the stockholders of $6.5 billion, and it just so happens that the

Federal tax revenues were enhanced by over $2 billion in this particular transaction.

I cannot see any problem with continuing to let these deals go ahead, not just the Gulf deal. I am talking about other deals across corporate America. I think it is causing accountability here. It should be there.

I think if you pass any legislation that it should be looked at extremely close that you are not entrenching the entrenched management. I think that is a sad situation when these people have no ownership, but are allowed to continue in positions making decisions that are unwise on behalf of the stockholders.

That concludes my remarks.

[The complete statement follows:]

STATEMENT OF T. BOONE PICKENS, JR.
PRESIDENT, MESA PETROLEUM COMPANY
BEFORE THE SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS
October 2, 1984

I appreciate this Committee's interest in my views on S. 2797, Senator Chafee's bill requiring that each director of a corporation own at least 1,000 shares of stock in that company. As one who has served on a number of boards and been an active participant in American corporate life, I feel this bill deals effectively with what I see as a too common problem in the board rooms of America today. The problem is that boards all too often think of what is in the interest of management first and shareholders second.

Shareholders are the cornerstone of our free enterprise system. As I stated in a recent letter to Senator Riegle on the related subject of "greenmail":

> "The linchpin of our successful securities markets is public confidence. The shareholder must believe that he will get a fair shake -- that he will be provided with accurate information and that once an investment is made, he will be treated equally with all other investors."

During my business career I've maintained a commitment to one basic principle: that shareholders come first. I think we at Mesa have demonstrated that if a board of directors and management follow the principle of shareholders first a company can grow, return value to shareholders, create jobs and benefit consumers. On the other hand, when companies are operated to

perpetuate management, everyone loses -- particularly shareholders.

By ensuring that each board member has a financial interest in protecting shareholders, Senator Chafee's bill should make Boards more responsive to shareholders' interests. As Harold Geneen, former ITT chief executive officer stated in the September 17 issue of Fortune, "Whenever their own money is involved, board members will not hesitate to ask all sorts of questions of the managers running the company, and they won't be satisfied if performance does not come up to expectations." I believe many individuals serving on corporate boards today are vulnerable to the charge that they don't have enough confidence in the companies on whose board they serve to make more than a token investment in their companies. If they don't have confidence, why should shareholders?

For example, at Mesa we found during the course of our tender offer for Gulf that the top three officers at Gulf owned less than 1/10 of 1% of the outstanding shares of the company and the Board ownership was less than 3/10 of 1%. When board members and officers do not have a personal stake in their companies they often act merely as caretakers for management, more interested in perks and power than with shareholder values. This kind of arrogance is becoming increasingly unacceptable to shareholders. When shareholder interests are put first, companies grow, capital is created and the free enterprise system works.

I think Mesa is a good example of that. I started Mesa Petroleum's predecessor company in 1956 with $2,500 paid-in capital. In 1964 we went public and our assets were slightly less than $2 million at that time. By 1984 we have a company that has assets of approximately $3 billion. Mesa's directors are substantial shareholders in the company and, I believe, put the interest of Mesa's shareholders first.1/

I would also like to point out that in working for our shareholders Mesa has demonstrated that mergers and acquisitions are a healthy and integral part of our free enterprise system. The result of our Gulf investment and the subsequent SoCal-Gulf merger has been just as I predicted before a number of Congressional committees a few months ago. Gulf's assets are in stronger hands and that benefits the shareholders, the company, the economy as a whole and consumers in general. As Newsweek magazine stated in its October 1 issue, "Shareholders came out

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1/ The members of Mesa's board own approximately 4% of the outstanding shares of Mesa Petroleum Company. Individual ownership including direct and indirect ownership is as follows:

T. Boone Pickens, Jr. (Has an option for additional 1.9 million shares)	1,531,189
David H. Batchelder	16,940
Harley N. Hotchkiss	50,000
Jack K. Larsen	495,000
Wales H. Madden, Jr.	376,000
Robert L. Stillwell	14,120
Cyril Wagner, Jr.	11,500
Jerry R. Walsh, Jr.	96,264

ahead when Standard Oil Company of California bought Gulf." Moreover, I think the recent drop in interest rates runs contrary to the predictions of those who asserted that merger activity has an adverse impact on the availability and the cost of credit.

Ultimately, the best check on a caretaker board is to increase shareholder awareness and the willingness of shareholders to exercise their rights. Shareholders are beginning to get the picture. Disrespect on the part of directors and management for the interests of shareholders, which Senator Chafee described on the introduction of his bill, hopefully will be curbed in the future by a more aggressive attitude among shareholders. It is my belief that institutional holders will probably lead this trend due to their fiduciary responsibilities, their research capabilities, and their ability to organize significant numbers of voting shares to bring real pressure to bear on directors and management.

As evidence of a growing public awareness of the role of shareholders in our free enterprise system, it is interesting to compare the recent attitude of the press in this area to that of just a year ago. In the same Newsweek article I mentioned earlier I see statements like ". . . best interests of the shareholders" and ". . . protecting shareholder interests, of course, is the duty of the corporate board of directors." I believe that the increased public attention to the flurry of takeovers and acquisitions in the last year or so has brought about a needed

reexamination of the importance of shareholders to our economic system. This is healthy, and it should be encouraged. The same sound reasoning lies at the heart of S. 2797.

I urge Congress to carefully consider all legislation in this area. Among some there is a tendency to examine particular deals and say this deal can proceed while another one cannot. We should not tamper with the balance that exists in our capital market system. Our capital markets are one of this nation's greatest assets. If shareholders assert their rights and we avoid the temptation to tinker excessively with the rules, the U.S. capital markets will continue to function in a manner that benefits shareholders, consumers, and economic growth.

In conclusion, S. 2797 is based on the valid principle that if directors have a personal stake in the performance of their companies they will tend to oversee the management of those companies more thoroughly and with less deference to corporate managers. I believe the bill represents the kind of director involvement on behalf of shareholders that we should all be trying to encourage. Ultimately, it is the shareholders whose interests should be considered in devising legislation to regulate corporate governance.

Senator D'AMATO. Mr. Pickens, I thank you for coming to testify.

Let me suggest this. In the interest of time, I'm going to ask any of the members, starting with Senator Chafee, if they would hold their questions to Mr. Pickens down to 5 minutes.

Mr. PICKENS. I'm not that pressed, Mr. Chairman. I'm OK. Up till 3:30, I'm all right.

Senator D'AMATO. Senator Chafee.

Senator CHAFEE. Mr. Pickens, let me say that I heartily concur with everything that you have said, and you and I are singing the same tune, although perhaps you might be singing it with more eloquence than I.

TAX PROBLEM FOR DIRECTORS

Let me just ask you this. In connection with the questions that Senator Lautenberg raised, going back now to 1,000 shares of ownership, somebody comes on the board of directors, let's say they're receiving $30,000 a year in director's fees, and they don't own 1,000 shares. They own 500. So therefore, their $30,000 for the first 2 years, let's say, has to be completely devoted to the purchase of shares. At the same time, they've got to pay income tax on the $30,000.

Under the proposal that I have submitted and that you have espoused, we do have the problem that Senator Lautenberg touched on, that the person is receiving no money to pay his income tax. What's your answer to that?

Mr. PICKENS. These people who are coming on these corporate boards are not paupers. [Laughter.]

I have no problem with that. If their taxes are 50 percent, as Chairman Shad said, that they're getting it for 50 cents on the dollar. I have no problem with that. They can go borrow the funds if they want to. But you will find, I would say, that 99 percent of the people coming on boards, that won't bother them at all.

Senator CHAFEE. Well, I agree with you, except, of course, we do get back to the situation of the so-called public representative, whoever he or she might be. In order to broaden the base of the board, they may want the head of the local boys' club, or whatever it is, and that person, indeed, if not a pauper, has no extra dollars.

Mr. PICKENS. Well, Senator Chafee, the thing is that the 50 cents on the dollar is what they're buying the stock for by paying their taxes, well, that's nothing more than margin financing. So that's easily financed. I mean the bank will loan the money on that. It's a minor point, but if you want to split it down and let them take some of it home to pay some taxes with, I won't have any problem. To get their ownership up is the thing. I want them to have financial risk.

Senator CHAFEE. I suppose, by definition, if the person isn't very well off, that person also isn't in the 50-percent tax bracket.

Mr. PICKENS. That's a good point, yes.

Senator CHAFEE. All right. Fine.

Now those are the only questions I have. Again, I want to thank you very much. Mr. Pickens came all the way from Amarillo, TX, at my request to testify here today, and has a speech in New Orle-

ans tonight. I assume none of the Gulf management will be present.

Senator D'AMATO. Mobil is watching, John.

Senator CHAFEE. But again, I want to thank you for coming.

Mr. PICKENS. Thank you.

Senator D'AMATO. I know Senator Lautenberg wanted to ask Mr. Pickens some questions. Senator Lautenberg.

Senator LAUTENBERG. My background, just for the benefit of the discussion here, is in the corporate world, and I was CEO of a fairly significantly sized corporation and sat—unfortunately, nobody loved us and was willing to pay huge premiums for my company. Maybe they would have had it.

Mr. PICKENS. I look forward to that day too when somebody will pay a huge premium for Mesa.

Senator LAUTENBERG. Well, since I'm no longer with the company formally, I can't invite offers, I can tell you that. But the one thing you struck a very good note, my distinguished colleague, the fact is, without some kind of reason for thoroughly reviewing these things is that you're not doing an adequate public service.

And I would ask you, Mr. Pickens, rather than try to construct programs where directors have equity, if we can remove the conflict issue and assign them essentially a public responsibility, have we not done the same thing? And let me tell you exactly—I, as CEO of my former company and chairman of the board, used to make sure that the people who were coming to that board were people who, I, felt could contribute, but also whom I knew. It made it very friendly and, very frankly, we have—my company, ADP, had a very distinguished board, both Republicans and Democrats, I might add—of significant prominence and we treasured their input.

EUROPEAN BOARDS NOT PICKED BY CEO

One thing I knew, however, at any time was, that if there was anything they felt was not right with the company, they were going to ask the right kinds of questions. I don't think that's typical. What happens in European boards, as I'm sure you have seen, and I know John Shad has seen—we've talked about this—is, the board members are not picked by the CEO, who has got to be their friend, who have essentially a public responsibility. They can be picked from a distinguished list of directors, and who will serve the public interest or the shareholder interest by saying, OK, my duty is to make sure this company performs well, and not at all to protect management.

Have you ever looked at that kind of a structure and given it any thought?

Mr. PICKENS. I have. Let me just read off the ownership in Mesa. I go from an ownership point. When I feel that directors have some money out there, they're going to start looking after it. They're going to have a much deeper regard for the stockholder.

There are eight directors at Mesa. Let me just read what the ownership is on that board. I will not read by name, but the largest is 1,500,000 shares—and I'll just round these off—17,000, 50,000, 500,000, 400,000, 14,000, 11,000, and 100,000.

Senator LAUTENBERG. Were these options?

Mr. PICKENS. No, that's direct ownership. I exercised an option for a portion of the 1,500,000 shares. I was a founder of the company, and I bought in open market purchases, a considerable amount of stock, which I am doing at the present time.

Senator LAUTENBERG. Were they friends of yours, Mr. Pickens?

Mr. PICKENS. Yes, they were friends.

Senator LAUTENBERG. I don't think friendship is bad, but if we're trying to get a situation where the directors are saying, I'm going to decide this issue based on what's good for the shareholders, I think you have a serious problem with whether or not there is equity. I approve of what John Chafee has recommended, in substance, because I remember a takeover offer made against ADP by Gulf & Western, and the chairman of the company, if I remember correctly, had 50 or 200 shares. It was either one of those two amounts. Talking about what was good for the shareholder—and it was a total waste, in my view, because they were protecting a very poorly operated company.

That was 15 years ago, and I think if we maybe didn't have the chairman of the board as the CEO picking the directors, it might bring some arm's length considerations in here and not have to sweat whether or not they have the assurances, because one of the things that I can get concerned about is, if a director has a significant equity interest, is his head turned a little bit or her head turned a little bit by the value of an offer. And therefore, you get out of the evaluation of what is good as contrasted to what is higher priced.

Mr. PICKENS. May I make a comment about that? I get everything boiled down pretty quick to this point—that any premium to market offer, I think is very dangerous for a board of directors to turn it down. I made offers to four companies about 7 years ago. I made them all in 1 day, and they were bear-hug offers, each one of them. I never did hear from one of them immediately. They never even showed the courtesy to turn it down. All of them were premium to market offers of, about 50 percent for small oil companies, and I believe I heard from two of them in 30 days. And one of them called me about a week later. They felt no responsibility to the stockholders, to offer that to the stockholders.

Senator LAUTENBERG. My time is up, Mr. Pickens.

Could you just give me a yes or no as to whether you think it would be advisable to have nonhand picked directors—have them come from the business community or public sector? Do you think that would make sense?

Mr. PICKENS. I don't know. I read Harold Geneen's article, and some of the things I agreed with Geneen on and some I didn't. One was that the CEO of the company should not be the chairman of the board. I did not agree with that. I think you get into a position there where you have outsiders trying to run the company. It's difficult. I have problems with it. The whole structure. I don't like parts of it.

Senator LAUTENBERG. Thank you, Mr. Chairman.

Senator D'AMATO. Senator Riegle.

Senator RIEGLE. Thank you.

Senator D'AMATO. By the way, we are in the position of being in a live quorum call. So, at some point in time, we are going to have to get to the floor.

Senator RIEGLE. I am just going to ask a few specific questions.

OBJECTIONS OF SEC

On the issue of whether a director should have to own shares of these companies, the SEC has responded to this question in several ways. I want to give you a couple of their responses and then I would like to hear your thoughts about them.

The first objection by the SEC was to the effect, and I'll just quote them:

> The qualifications of directors goes to the heart of corporative governance, an area widely accepted to be within the prerogative of State corporate law and the charter and bylaw provisions of individual issuers. To begin to establish Federal qualifications for directors of all public companies would be an extraordinary preemption of State corporate law.

How do you respond to that objection the SEC raises?

Mr. PICKENS. You're asking me to comment about a legal matter; right?

Senator RIEGLE. Well, in effect, it is a legal matter. It is the first objection they have given us in their list of prime objections, so I assume they consider this perhaps the most important.

Mr. PICKENS. Give it to me again?

Senator RIEGLE. Well, they're making the point that the qualifications for boards of directors are widely accepted to fall within the jurisdiction of State corporate law and the charter and bylaw provisions of individual issuers, presumably under State law. They go on to say that if we start to establish Federal qualifications for directors of all public companies, then that would in effect become an extraordinary preemption of State corporate law, which now applies.

Mr. PICKENS. I am in agreement with the SEC on that point.

Senator RIEGLE. Well, I wonder how we get around this if we're going to set some kind of requirement that corporate directors hold some number of shares. In a sense, that would have to become a corporate requirement or, I should say, a Federal requirement that would invade the State's prerogative here.

Would you feel strongly enough about it to say that if this is what it takes, we ought to do it anyway because of the need to turn these directors into significant shareholders?

Mr. PICKENS. That's a tough question. I want them to be stockholders and to have something at risk, but I don't want to get the Federal Government so involved that it is going to preempt some of the State corporate statutes. And, so, I don't know, it's a tough one. Can I pass on that one?

Senator RIEGLE. Well, you can for now and I agree with you, it is a tough one, but I think it goes to the heart of the question: Is it practical to do this? I'm interested in the idea, and I like the notion of directors having some owenership stake in the company. I think it's an attractive concept, but I'm wondering how we can accomplish it within the layers of law that now exist.

Mr. PICKENS. Well, we found out that when we passed laws, we didn't realize what happened someplace else. And, all at once, you brought that up and I'm concerned about it.

Senator RIEGLE. Let me just list one more SEC objection of this approach. They say this as point No. 2:

> Such a share ownership requirement could make it more difficult to recruit qualified directors. Even with the provision that the requirements may be met by the purchase of stock, with directors fees as they are paid, the requirement may discourage potential outside directors, particularly from academia, labor, consumer groups, minorities, and other constituancies. Those who would have to rely on the acquisition of stock through the application of fees may not be able to give their time in return for compensation which essentially takes the form of equity that must be held as long as they are directors. For example, a 1982 Commission study of 961 companies indicated that 77 percent paid directors annual compensation of less than $10,001. Assuming market prices of $10 to $50 per share, it would take at least 1 to 5 years for directors of these companies to satisfy a 1,000-share ownership requirement. They would receive no cash compensation for their time over such an extended period and would be required to pay taxes on their compensation, without receiving any cash to do so.

Again, that's their verbatim response, and I would be interested in your reaction to that.

Mr. PICKENS. Well, I'm not in agreement with that. I think if they are going to be on the board they should have something at risk. I keep saying the same thing over and over but I think the cheapest way I know to acquire equity in a company would be to have somebody pay me a director's fee, which would go to the purchase of stock. So I don't have any problem with that one. The first question, I do have but not this one.

Senator RIEGLE. So, I gather your view is that most people who serve on corporate boards of directors are financially situated in such a way as to be able to take their director's fees in this form, or buy the shares outright, as a condition of serving as a director?

Mr. PICKENS. Exactly. Any time after I talk to the nominating committee and we make a request of somebody, would you like to go on this board, I make it very clear to them we expect you to be a meaningful stockholder.

Senator RIEGLE. I see.

Mr. PICKENS. And that's the way it's been with me, too, on the boards I have gone on. We don't want you on there with, you know, a 100-share ownership.

Senator RIEGLE. Right, I thank the Chair, and I yield.

Senator D'AMATO. Senator Metzenbaum.

Senator METZENBAUM. I don't actually have any questions except to make one comment. That is that I think 1,000 shares sounds good, but for most corporate directors of major corporations, the amount of money involved is so insignificant that it would not really be meaningful and affecting their judgment.

The corrollary is that if you increase it substantially more, or you preclude people that are more representative of the general community from serving on the board, they should recognize that Senator Chafee's proposal is that they be paid in stock so they wouldn't have to be laying out the money. Senator Lautenberg points out as a text aspect.

DIRECTORS SHOULD HAVE SENSE OF LOYALTY TO SHAREHOLDERS

I guess what I'm really saying is I don't oppose this proposal but I'm not sure that it really cuts at the real issue that you are talking about, and that is seeing to it that the directors have a sense of loyalty to the shareholders in contradistinction to loyalty to the chief executive officer or the management of the company.

Mr. PICKENS. I can't find a great deal of argument with what you're saying. I realize that 1,000 shares may not be a significant amount to really put somebody at risk. I think it does show good faith, if nothing else.

You know, what really bothers me, I sit there and look at a list of directors and see 100 shares. One particular Gulf Oil director, I think, had 126 shares. On the Shell Oil Co. stock directors, there were two on there, I believe, that had zero shares. Well, you know, if I'm a stockholder and I look down at that, I think, by golly, they don't have much faith in this operation. But I know they are sitting there drawing director's fees of somewhere between $25,000–$50,000 a year.

I suppose the 1,000 shares could be identified as a token. I think that could be the case, but, still, I would rather see that than see 100 shares. If somebody isn't going to serve because they don't want the money to go to buy the stock, that also would be meaningful to me if I was the CEO of the company.

Senator D'AMATO. Senator Dodd.

Senator DODD. Just very quickly, the same sort of point Senator Metzenbaum made. I don't know if there's any answer to this either but when you have your boards of directors with a significant interest, say, more than 1,000 shares, as in the case of the company you listed, your directors as having substantial—at least, it sounded substantial—quantities of stock, do you also potentially run into the problem of having been somewhat more amenable to tender offers at premium prices?

Looking at that sole aspect of it, they are more inclined then, I suppose, to jump at that kind of offer, given the premiums that are being proposed, not looking at the entirety of the importance to the company—the nonspeculating shareholders, employees, and others that may not have the direct financial involvement of only stock, but certainly a financial interest in the company possibly not passing on to the bidder.

EFFECT OF ACQUISITION OF COMPANIES

Mr. PICKENS. Well, Senator, you know, it seems like there's a feeling that when a company is taken over, that somehow it's destroyed. I had people talk to me about Gulf Oil—that I had in mind destroying Gulf Oil. Well, that was ridiculous, because we had a $1 billion investment we actually put at risk. Why should we want to destroy anything?

So, for a company to be acquired doesn't necessarily mean that the employees are going to be fired.

Senator DODD. No, I wasn't suggesting that.

Mr. PICKENS. But as the CEO of Mesa Petroleum, anytime there's a premium to market offer made to us that we will either do one of two things. There will be a short directors meeting. One, we have

either got to get the price up from somebody else, or two, we just sold out. It will be that short. Now, I would not feel comfortable—let's say Mesa stock today is $20 and somebody came in with a $25 offer? The first question to our management would be is: How quickly could you move the price of this stock to $25? What's the reasonable expectation for our stockholders? If they say: "We just made a big oil discovery in South Louisiana and we think the stock will go up in 30 days or 60 days, that is reason to reject the offer." If they say, "We can get it up in a year or two," that won't cut it, as far as I'm concerned. We just have sold out for $25 or better.

So, to me, a premium to market offer is terribly important to the stockholders—and that's who I'm working for.

Senator DODD. All I'm getting at is, again, like everyone here, there's a certain attraction to Senator Chafee's proposal. I'm just wondering if it is going to have the kind of effect he expects. If you want to get up to $25, you have subsidiaries that are worth more than others and you can get rid of them, and you do other things that may have an overall adverse effect in order to satisfy the price on that stock.

Again, I'm not——

Mr. PICKENS. Wait a minute, I'm not following you on the subsidiary statement.

Senator DODD. Well, you may do all sorts of things. I presume if you get up to $25 and the shareholders may make certain decisions which would be advantageous to the shareholders but, say, not necessarily advantageous to the overall company at large—the employees, for instance, or the nonspeculating shareholder.

Mr. PICKENS. Wait a minute. We, fundamentally, either agree or disagree on something. Who is it that owns the company?

Senator DODD. The shareholders.

Mr. PICKENS. OK, and you say the shareholders are for it but the employees are not.

Senator DODD. Well, I'm not saying the employees ought to be the deciding factor. I'm just asking you whether or not you think there are considerations other than exclusively the shareholders' interest?

Mr. PICKENS. Oh, I do not think so. I mean, if you were going to sell your house that you had bought for $25,000 and you were offered $100,000 for it, do you think there's somebody else that should be considered other than you?

Senator DODD. Yes; my family, for instance.

Mr. PICKENS. You and your family.

Senator DODD. There are others that are part of the family.

Mr. PICKENS. I'm saying you are the owner. Would you not sell your house because of the neighborhood?

Senator DODD. Well, I don't put my house in the same status as I do somebody who employs thousands of people, and may be important to the community. Again, I'm not saying the decision ought to reside there. What I'm raising is, in a sense, in this case here, this particular decision isn't necessarily going to guarantee or protect against the kinds of problems that were apparently raised in this issue in the first place.

Mr. PICKENS. I don't think it's going to solve everything.

Senator DODD. It's not a panacea.

Senator D'AMATO. It's not a panacea. I think that is what Senator Dodd was trying to point out.

Mr. PICKENS. I'm sorry. I missed the point.

Senator DODD. I'm saying there are other considerations.

Mr. PICKENS. I kind of rise to the stockholders.

Senator DODD. If I had 1 million shares, I'd rise, too. [Laughter.]

Mr. PICKENS. But 1,000 shares may be that important.

Senator D'AMATO. Mr. Pickens, let me thank you for coming in, and I have not taken my 5 minutes, nor do I intend to because that bell is summoning us and we have 7½ minutes to get down to the floor.

I applaud Senator Chafee's efforts in highlighting an important issue.

We have seen a tendency of management to look out for themselves as opposed to what is the best interest of the stockholders.

So I commend Senator Chafee.

Senator CHAFEE. Thank you very much. Mr. Chairman.

I want to thank Mr. Shad for stepping aside so Mr. Pickens could testify.

Briefly, I just want to ask you gentlemen a quick question. A lot of people think, that with, say 1,000 shares of stock selling for $30 or with IBM selling for $120, it is going to take a long time to acquire the total if you don't have the money to purchase outright.

FEES RANGE FROM $30,000 TO $50,000

Just for the record, is it safe to say that in the major corporations the directors' fees, including not only the retainer but the attendance fees for the meeting, plus their committee fees—you can't generalize completely, but certainly these—would you say, Mr. Shad or Mr. Pickens, from your experience that these fees range from $30,000 to $50,000 a year? Is that safe to say?

Chairman SHAD. Well, I quote a number from the SEC study, which is that the vast majority of fees are in the $10,000 or less category. The vast majority.

Senator CHAFEE. Yes.

Mr. PICKENS. But he is talking about major corporations.

Chairman SHAD. But if you take the Fortune 500, yes, the $30,000 to $50,000 figure certainly would be in the ballpark.

But I was just getting to the point of talking to this issue, so I am not going to repeat things Senator Riegle raised, but the SEC favors broad equity ownership by directors, and in fact most do own stock. We are sort of making an issue out of it today. Maybe it isn't as big an issue as it might seem.

I haven't seen any good survey. We were looking, in the short notice we had for these hearings, to see if we could come up with some hard facts, but we have consulted one of the best experts in the field, Lester Korn of Korn Ferry, which is the nationally recognized concern that does surveys of this type.

He authorized me to quote him at this hearing as saying—and I want to be sure I say it right. It is his considered opinion that a very large portion of directors already own stock in the companies in which they serve.

Senator CHAFEE. Mr. Shad, I will tell you what. We are in the last minutes of a rollcall over there. Are you going to come back, Al?

Senator D'AMATO. Yes; what I would suggest is——

Senator CHAFEE. I can't come back, unfortunately, but I am going to have somebody here to catch the balance of your statement.

Senator D'AMATO. I am going to ask if we can take a brief recess for about 15 minutes, and I will come back, and conclude the hearing.

Senator PICKENS. May I have just 15 seconds?

Senator D'AMATO. Yes.

Senator PICKENS. I appreciate very much the attitude that all of us have about what we are trying to do, and that is to work for stockholders and not work for these entrenched managements, and I appreciate being here.

Thank you very much.

[Additional comments for the record submitted to Senator D'Amato from Mr. Pickens follow:]

T. Boone Pickens, Jr., president

MESA
PETROLEUM CO.

October 15, 1984

The Honorable Alfonse M. D'Amato
United States Senate
Washington DC 20510

Dear Senator D'Amato:

I appreciated the opportunity to testify before the U. S. Senate Committee on Banking, Housing and Urban Affairs on October 2, 1984 in order to discuss certain tender offer practices and corporate director responsibilities. After reviewing the transcript of the proceedings, I wish to clarify four items raised in my testimony. Accordingly, I ask that this letter be made a part of the official record of the proceedings of that hearing.

First, on several occasions, the question was discussed concerning the payment of taxes when stock would be purchased as a result of Senator Chafee's proposal. During those discussions, I believe everyone incorrectly assumed that the tax payment would be deducted from the price of the stock, with the result that anyone purchasing stock would purchase stock at a discounted price. For example, everyone appeared to assume that a person in the 50% tax bracket would be purchasing stock for $.50 on the dollar. Upon reflection, I believe this result is neither correct nor desirable. What I believe is correct and desirable, and what I suggest occur, is that the after-tax proceeds for directors fees be used to purchase stock until 1,000 shares has accumulated.

Second, I wish to make it clear that Mesa has never participated in a two-tier tender offer with substantially different values between the two steps. Mesa has on occasion made a tender offer for less than 100% of the stock, with the result that some type of second step would have been required to complete the merger. Under no circumstances have we contemplated any additional steps with values substantially below the initial step.

Third, I wish to make it clear that my remarks on page 62 of the transcript concerning premium to market offers made for Mesa will apply to every circumstance unless such an offer is made as a defensive "Pacman" strategy on the part of another company. Because Mesa's overall strategy to increase value for our shareholders might result in a "Pacman" offer for Mesa's stock,

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Mesa's Board of Directors might well conclude that such an offer is not in the best interest of Mesa shareholders.

Finally, my written statement indicated that I owned an option for 1,900,000 shares. The table should have indicated that this was the amount of an option exercisable this year. In total, I have a option for a 4.8 million shares of which 1.9 million shares is exercisable this year.

I appreciate the opportunity to correct the record on the matter.

Sincerely,

T. Boone Pickens, Jr.

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Senator D'AMATO. Thank you, Mr. Chairman, also, for your patience.

[Recess.]

Senator D'AMATO. We will resume the hearing, and let me extend the committee's thanks to Chairman Shad for being so patient and so very, very accommodating, as he has always been to this committee and to all others.

And, before we got to some of the questioning of Mr. Pickens, I think you had some other observations that you were prepared to make, and also I think it might be fair for us to listen to you in terms of your observations with regard to Mr. Pickens' testimony and other areas that you might want to touch on.

Chairman SHAD. Thank you very much, Senator D'Amato. I was going to give a very brief further comment on the other two proposals that I had not quite reached, and then, in particular, Senator Chafee's proposal on the 1,000 shares.

I am not going to repeat things that have already been put in the record by Senator Riegle and in reading some of the views of the Commission.

I will just summarize by saying that the Commission agrees that it is desirable for directors to own stock in their companies and believes that most do, and I made that point just a moment ago with the opinion of one authority on that subject.

And the reason we don't support the recommendation is the preemption of a fundamental area of State law—the qualification of directors. I am not going to go through the arithmetic exercise of people having to pay taxes on their directors fees, and so forth, but I would toss this thought in. Also a large portion of companies have very low-priced stocks—where requiring ownership of 1,000 shares in a low-priced stock would have negligible results.

Therefore, if Congress were to decide to enact such a proposal, it might be desirable to equate the number of shares to those that could be purchased with 1 year's director's fees, rather than setting

a fixed number of shares. At least that would be some sort of a reasonable equation, whether it was General Motors or a penny stock—1 year's director's fees.

Nevertheless, I hasten to add, the Commission still opposes the proposal for the reasons I previously mentioned.

Now, the final item to which we were asked specifically to respond was the proposal by Senators Chafee and Heinz that would create a Federal cause of action to challenge directors' decisions in charge of control transactions. This proposal would essentially create a Federal business judgment rule.

Although the Commission shares certain concerns regarding the application of the business judgment rule in takeovers, it does not believe that such extraordinary preemption of State corporate law is warranted.

Further, the proposed legislation would extend to all major corporate actions that could affect control, including friendly and hostile tender and exchange offers, mergers, financings, liquidations, proxy solicitations, and other actions.

GREATER RECOGNITION TO POTENTIAL CONFLICTS OF INTEREST

Moreover, there are indications that traditional philosophy is changing and that courts are giving greater recognition to potential conflicts of interest between management and shareholders during takeover contests.

The second circuit's recent decisions in *Norlin Corp.* v. *Rooney Pace*, and also *Joy* v. *North* are noteworthy examples of the courts starting to insist on greater accountability by management, that their conduct be in the interest of the company and the shareholders and not merely the management's self-interest.

So to conclude, the four proposals under consideration are innovative approaches to important issues, but the Commission does not support them at this time for the reasons stated.

Thank you, and I will be glad to respond to questions.

Senator D'AMATO. Senator Chafee.

Senator CHAFEE. Thank you Mr. Chairman.

Well, Mr. Chairman, I want to thank you for your observations. I think they have been helpful.

First of all, on that second proposal, I had some misgivings myself on it. I wasn't pressing that to the degree. It was the proposal regarding 1,000 shares. I think there may be problems with this Federal cause of action, knowing the activist lawyers who go out and sue on anything. Pretty soon, you might well have all corporations tied in a knot, no matter what kind of a decision management has made. The only beneficiaries would be the legal department. So I think your points were well taken.

On the first one, obviously we considered the problem of corporations, like IBM selling for $120 a share and other companies whose stock is selling for $17 a share. The difference between acquiring 1,000 shares is very substantial. Perhaps your suggestion that a year's worth of director's fees would be required to purchase stock is a solution, although, again, we have got the problem, as you so aptly point out, of the Federal Government getting in; that is, Federal law applying to corporations which are incorporated by States.

I wish I were as optimistic or sanguine as you are about the holdings of directors of shares. Yes, certainly in most corporations the directors hold some shares. But you have looked over a zillion proxy statements, many more than I ever have. But the ones I have looked at bear out quite eloquently and starkly the comment Mr. Pickens made. I'm just stunned that these directors of major corporations somehow feel they have met their total obligation by buying 100 shares. And therefore, they're fine, they're representing the stockholder.

Maybe they are, but I wish they'd put a little of their own money in.

Chairman SHAD. I agree with you. I feel it would be very desirable for directors to have substantial holdings from a security analyst's point of view, which is my background. When analysts look at a company and see a negligible holding by the officers and directors, it tends to suggest that they're going to be very aggressive in defending a takeover because they don't have a large investment. If they have a large investment, as Mr. Pickens characterized it, they're probably going to be much more receptive to a takeover, because they're going to weigh it in terms of what it means to their pocketbook rather than their status as directors. But I would also question the suggestion of Mr. Pickens, and it was raised from the dais also, that they do, at the time they go on the board, buy a large block of stock. It makes a tremendous difference what your timing is in purchasing a block.

Mr. Pickens has 1,700,000 shares of Mesa because he was a founder. He didn't get into what his average cost for those shares was.

It's quite another thing to take IBM, where they are today, and say we want you to buy $1 million worth of IBM, a small number of shares, but a big investment. So there would be two decisions involved in going on a board. One is an investment decision of whether or not, today, when I'm being asked to become a director, the stock is a good buy, that's one question. The second is, whether I want to serve on this company as a director. And so, in any case, I don't want to cloud the Commission's fundamental position on it, which is that we do oppose the idea because of the preemption of a fundamental area of State law—the qualifications of directors.

Senator CHAFEE. Well, I see your point on that. I was speaking from a certain sense of frustration, I guess, and how to solve it. But we are grateful for your comments.

Chairman SHAD. Thank you, sir.

Senator D'AMATO. Before I ask Senator Metzenbaum if he has any other questions, I'm wondering, Mr. Chairman, if you would address that proposal put forth by Senators Specter and Metzenbaum. What is your view with respect to that issue? I have grave doubts about it myself, because I think there's a possibility of simply stymying investment, not just acquisitions, but venture capital. These proposals would halt joint venture activities.

SHAREHOLDERS FAVOR TWO-TIER TENDERS

Chairman SHAD. The Commission's position—to give you the simple and direct statements—is we share some of these concerns

and are sensitive to them. Therefore, we are engaged in a major assessment of the alternative approaches—how to do deal with them, the degree of concern, the justification for it. We have already developed the facts which are in our formal testimony that refute some of the opinions that are expressed concerning partial and two-tier tenders. I have no reservation in stating to this committee that shareholders prefer to have a two-tier rather than a partial tender offer, because they get a bigger premium up front and on the back end. They come out ahead in both. They prefer a two-tier to a partial tender. And I can also say, without reservation, they would prefer a partial to none. And so I question whether we really ought to deprive them, if we want to do something good that the shareholders will applaud, not scream over. And I agree with you, under the ideal world, you would have all-or-nothing tender offers.

Senator METZENBAUM. Mr. Shad, you made a statement again that investors prefer this? How do you know that?

Chairman SHAD. Two-tier tender offers?

Senator METZENBAUM. Yes.

Chairman SHAD. All right. Because the arithmetic is so clearly in their interest. That is the reason I make that statement. Do you want me to state the arithmetic?

Senator METZENBAUM. Sure.

Chairman SHAD. On the average, in two-tier tenders the first step premium is 64 percent, and the second step premium is 47 percent. Take a blend of those two, weighted by the amount that comes in on each, and you get a 55-percent average premium. Do the same exercise on partials, and you get a 31-percent blend. Now it doesn't take much experience to say it's much more in the shareholders' interest to get the 55-percent premium over the prime market price of their stock on the tender than it is to get 31 percent and not be sure—I want to be very accurate about this.

Senator METZENBAUM. I'm not sure that's the whole equation, because who are the tenders, those who are the offerors, aren't out of their cotton-pickin' heads. They just don't throw money away. They make two-tier tender offers, because they want to gain control for a lesser amount of dollars than it would require in order to buy 100 percent of the shares. And so you arrive at that and point out this 54 percentage as against 31 percent and arrive at a conclusion, the same way you arrive at the conclusion that because 13 percent didn't respond, that that indicates how well it's working. But let me just point out to you that——

Chairman SHAD. I didn't say that it indicates that, but I tried to explain who they were.

Senator METZENBAUM. What I'm saying to you is that the 87 percent that did respond were coerced into responding. If they didn't, in a two-tier tender offer, respond, they were going to get a lesser amount of money. So if they had enough brains and enough knowledge, they would go ahead and respond, but—Mr. Chairman, may I proceed at this point?

Senator D'AMATO. Yes, you may.

Senator METZENBAUM. You know, you repeatedly stated what your role is at the SEC. That's to protect all shareholders. And yet in each response that you have made here today, I get a protection

for a segment or a protection for a takeover company, and what I don't quite understand is how you can say you're protecting the shareholders, whether there's 13, or 5, or 2 percent that are left high and dry, and whether there are some trusts, or whoever they may.

Chairman SHAD. Senator, may I ask a question on that statement?

Senator METZENBAUM. Sure.

Chairman SHAD. Do they elect to be high and dry, or do they—in other words, there are a lot of people who oppose tenders. They're not in favor of tenders. They don't accept it. They are in the 13 percent. There are a lot of people who have restrictive trusts that don't give them the option of accepting an exchange offer. There are others. There are foreign investments and a lot of individuals who never respond to their mail. Are we going to be responsible for them?

Senator METZENBAUM. Aren't you worried about those, the widows, the orphans, and the others who don't?

Chairman SHAD. Not when they don't complain to the SEC. We're not getting any complaints that the time is inadequate or that they're not getting the opportunity to respond. That's not the problem. The analysts don't think it is.

SOCIETY OF CORPORATE SECRETARIES' STAND ON TWO-TIER ISSUE

Senator METZENBAUM. The fact is that there are prominent people who think that the time period is wrong and they think the two-tier offer is wrong. The American Society of Corporate Secretaries: "We strongly believe that 40 calendar days is insufficient, however, and urge 60 business days be required instead." Mr. Hennessey, Chief Executive Officer.

Chairman SHAD. May I respond to the first one?

The Corporate Secretaries, characteristically identify with corporate management and are concerned with being taken over. One of the things an increase in the minimum offering period would accomplish would be to tilt the balance to favor targets. You can expect the Corporate Secretaries not to be in favor of a short period.

Senator METZENBAUM. How about Felix Rohatyn? He's been on both sides of the issues.

Chairman SHAD. I know Felix well. What about him?

Senator METZENBAUM. He says:

> The tender offer should remain in effect for a minimum of 60 days, thereby giving all shareholders ample time to weigh their decision and evaluate the alternatives.

Chairman SHAD. He's more commonly quoted as being opposed to two-tiers.

Senator METZENBAUM. I know. I quoted him in my opening statement with respect to two-tier.

Chairman SHAD. He didn't have the benefit of this economic analysis that we have included in this testimony. I'd be interested in his reaction, once he has seen the extensive facts we have.

Senator METZENBAUM. I don't think it would change his——

Chairman SHAD. I do.

Senator METZENBAUM. He's not here today only because of some prior commitments. Ed Hennsey of Allied Corp., "Lengthening the minimum offering period from the present 20 business days would place all target company shareholders on a more equal footing."

I think they were just involved in a takeover where they were involved in taking somebody else over.

Chairman SHAD. Allied acquired Bendix.

Senator METZENBAUM. So therefore, it's not just the companies who are being concerned about being taken over.

Chairman SHAD. And Ed was a member of the SEC's Advisory Council on Tender Offers. I think he's a very capable corporate executive and has real reservations toward much of the takeover process.

Senator METZENBAUM. What bothers me is that you, a Government official—I gather you came from the investment banking industry, is that correct?

Chairman SHAD. That is correct.

Senator METZENBAUM. And you are now in a position where ostensibly you are there not to protect the banking industry or any segment of it?

Chairman SHAD. That is right.

Senator METZENBAUM. Are you there to protect the consumers?

Chairman SHAD. Absolutely.

Senator METZENBAUM. I don't understand how you can be opposed to provisions that make it possible for every shareholder to be treated equally and equitably with all other shareholders. You can have all the arguments about trust and have all the arguments——

Chairman SHAD. Can I answer that? I agree—I am glad you properly characterized my position. My concern is solely for the shareholders of this country and all other——

Senator METZENBAUM. Your actions don't speak as loud as your words.

Chairman SHAD. Well, let me finish my words first.

I believe if you do a good job for the shareholders the other fundamentals fall into place.

What you are proposing, I would say in the opinion of any professional that has done an analysis, would result in fewer tender offers. That is not in the interest of shareholders.

What you are doing is shifting the balance in favor of targets, and when you do that you are taking something away from the shareholders—the opportunity to receive a premium price for their shares in a tender offer. You are increasing the risk to the bidder, and as a consequence you are going to get fewer tender offers.

Senator D'AMATO. Mr. Chairman, if I might, Senator——

Senator METZENBAUM. You are the chairman.

Senator D'AMATO. Chairman Shad, if I might, it seems to me one of your arguments—and there is a certain amount of logic to it because I asked you initially why not an additional 10 days, and I am not suggesting to you that I might not think that 10 days would be appropriate. And I don't know.

I want to look very carefully at that testimony which you have submitted today in terms of the studies that have been made ini-

tially, increasing the offering period from 20 days to maybe 30 days.

If you were to move to 60 days, it would raise additional defenses to those who are attempting to acquire, and that this would hurt stockholders by stifling acquisitions.

Chairman SHAD. That is right.

Senator D'AMATO. And I think, Senator Metzenbaum, there is something——

Senator METZENBAUM. There are some arguments that can be made along that line.

Senator D'AMATO. I really believe, though I would like to see people get an adequate period of time, I am not convinced that 20 working days is or is not the answer. I just have not really come down one way or the other on that, and I am open—I do see where if you move to extend the period, then I also see your reasonable approach. And you said, well, what about 45 or something less than 60 days.

Senator METZENBAUM. I know what you are saying.

Chairman SHAD. Senator, you said it much better than I was trying to just a moment ago. I think that is the point.

Senator D'AMATO. Let me suggest this to you on the question of two-tier acquisitions, and I am going to make this offer to Senator Metzenbaum and not in any way attempt to dissuade him from further questions that he might want to put forth at this time, but because I think it is an important issue.

This whole area of tender offers, greenmail, defensive techniques, and two-tier offers that have been put forth really does require us to move with some thoughtfulness, purposefulness, and yet with a degree of speed and certainty that we are unaccustomed to in this body.

That is why I am going to indicate that it would be my hope to have extensive hearings and maybe 2 or 3 full days of hearings when we come back into session in our next legislative session.

And, of course, Senator Metzenbaum, we would, knowing your interest, would like and invite your full participation.

Senator METZENBAUM. I appreciate the chairman's interest and his cooperativeness in connection with this entire matter and his concern.

I would like to ask Mr. Shad a few more questions if I may.

Senator D'AMATO. Certainly.

MARKET PROFESSIONALS HAVE AN ADVANTAGE

Senator METZENBAUM. Would you not say the way the law presently works that the market professionals have an advantage over the average shareholder?

Chairman SHAD. I would say that in general professionals always have an advantage over amateurs, whether they are in the stock market, or golf, or any other activity, yes.

The person who has the intellectual capacity, devotes total time, and has computer and other resources tends to do better than somebody that doesn't spend any time on the effort. The pros are always likely to have the advantage.

Senator METZENBAUM. I have another concern about two tiers. By creating a stampede to tender at the higher price they allow a firm to gain control of the target for less than they could if there was more time to think about the offer and to solicit competitive offers.

Now, I am aware of the fact that the argument is that it also gives the management a chance to build up some opposition. But isn't the result, the way we are proceeding, far from maximizing shareholder value? Aren't you actually artificially holding down the takeover premium and perhaps encouraging more mergers?

Now, I know in your response you have compared two tiers as against one tier. I don't know that I know all the facts about how that study was made or exactly what was included in it.

But absent that and just on its face, doesn't your position do some harm to the individual shareholder, and isn't there some real basic inequity about it?

Chairman SHAD. Well, I appreciate your concern over the implication of coercion on two-tier tenders—what you characterize as the stampede to get in on the first tender. I don't want to be too broad in this statement, but there is a difference. You don't have an ideal test tube case to be able to make this generalization, but I would say all other things being equal you could probably end up acquiring a company at a lower net premium through a two-tier than you could through an all-or-any offer.

Senator METZENBAUM. I think you hit the nail on the head.

Chairman SHAD. But there are some tradeoffs in there that cause me to qualify it. There is less risk for the arbitrageurs and other people involved in doing these transactions if it is an all-or-any. There is no risk for the arbitrageur if the bidder is saying "I will take every share regardless of whether it is 1 share or 100 percent at x dollars a share." There is no risk arbitrage. It is a certainty then. The arbitrageur bids right up to within an eighth of the price and tenders it without risk.

Senator METZENBAUM. Isn't there a middle ground?

Chairman SHAD. I want to finish my point.

The reason I say I am not sure of this test tube generalization, all other things being equal, is that at least in my experience as an investment banker, I have done a lot of these transactions, and the premium will be less in an all-or-any because of the lower risk factor involved to the financial community and everybody else in taking advantage of what is a big premium over what the stock was selling for whether it happens to be 64 percent average premium or 50 percent. It is still a very attractive opportunity to realize a substantial profit.

And so if you really try to create this test to see, I am still going to concede to you your point earlier that probably there is a net advantage to bidders to go two tier rather than all-or-any. Just on the arithmetic that I have just been quoting from the economic study, it shows that the net blended premium is less.

But how do you account there—if that was the safe conclusion, for the declining number of two-tier offers, both absolutely and relatively in the last 3 years? The two tiers have been steadily going down. They are down to only 13 percent.

Senator METZENBAUM. I can hopefully say they've got more conscience, which is very doubtful. The other thing is that they may have decided there were other procedures that were equally available to them. I think that there is kind of a stickiness to making a two-tier offer. I'm the head of a company, and I make a two-tier offer and my family learns after the fact and they read about it in the paper that some people only got $60 and others got $80. And my children turn to me and say, "Dad, that doesn't sound very fair. Why did you do that?"

Now I don't think that's totally unreal.

Chairman SHAD. Well, can I tell you what I would answer to my son in that question? What they got was substantially more than they would have gotten if I had made a partial offer. They're much better off than if I hadn't done the second tier.

Senator METZENBAUM. Mr. Shad, I want to ask another question. They may have gotten substantially more, but it was actually worth more, so you didn't pay too much. The fact is that everbody apparently should have received something more than the market value, and why did you discriminate against some of these people who didn't act fast enough? I don't understand your procedure. Why couldn't you have said, we're going to buy 60 percent of the stock at $50, and we're not going to buy any more, and leave the other 40 percent in place. But instead of that, you did something different. You said we're going to buy 60 percent at $50, and that which we don't obtain the first go-round, thereafter we'll buy at $35.

Chairman SHAD. I think the answer I gave was the answer I would give to my son or anybody else as to why it was better for the shareholders to receive a two-tier offer rather than a partial. But I think some of the generalizations that are used to make this case are exaggerations. The average spread between the first and the second tier is 14 percent. It isn't the example you gave of $50 and $35. It's a common——

Senator METZENBAUM. Did I make up those figures?

Chairman SHAD. No, please, Senator. I'm sure if you look through all the tenders that have been done, you will find some at $50/$35, but I'm talking about the average of all of them.

Senator METZENBAUM. Well, the figures I used were based upon the facts as I understand them. Now if I didn't state the facts——

Chairman SHAD. No. I'm sure you took one example, but the average is a 14-percent lower premium on the second tier than the first.

Senator METZENBAUM. According to your records—this is where we got them from—it was a 63-percent premium on the average between 1981-83 and a 47-percent premium for the balance.

Now those are your figure's.

Chairman SHAD. That's right. And they're correct.

Senator METZENBAUM. OK. So why are you——

Chairman SHAD. Well, the difference works out to 55 percent blended premium.

Senator METZENBAUM. OK. Now why didn't you buy them all at 55 percent? Because we wouldn't have had the pressure on the

stockholders; wasn't that true? Why didn't we buy them all at 55 percent?

Chairman SHAD. I want to get the numbers-——

Senator D'AMATO. I would suggest at this point in time we have repeated and gone into this, and I don't mean to cut it short, but we do have another panel, and I would like to move on.

There is undoubtedly a certain amount of pressure which is exerted by those who make an offer or a two-tier basis. That is without question. And again, not at that point in time, personally deciding, until I have had an opportunity to study this question more closely, the correctness of this, but I do see, from the figures that that two-tier offer has come out higher than partial offers. So that's the No. 1 issue.

Second, it would seem to me that it is a unique opportunity for us to explore possible legislation which might give the shareholder the optimum participation. The English system, whereby the shareholders get a period of time to vote on all tender offers, appears quite appealing.

Chairman SHAD. They tender and vote simultaneously. If enough voted the offer down, even though it's at a premium, the offer is killed.

Senator D'AMATO. It's an interesting thing, and maybe we should have hearings on that. It would seem to me that would then do away with many abuses and give ultimate responsibility to the shareholders. In addition, it would address concerns raised by Senator Chafee with respect to boards of directors because you limit their ability to make a decision with respect to acquisition, et cetera, as you take it to the shareholders. I don't know what you think about that.

Senator METZENBAUM. Well, let me make an observation, because I don't think we need to debate the merits. It's no secret that given the appropriate vehicle, I will offer a floor amendment on this subject. Therefore—and it's obvious also, that we have 3 days to go, and so I'm not particulary talking about now. I'm talking about when we come back. I think that the SEC ought to share with us their views as well as the investment banking community, as to how, or why, or in what manner we believe some changes are needed, should best be drafted, in order to be fair and to do it in the best way possible, whether or not you agree with our position. And I would say, Mr. Shad—Mr. Chairman Shad—that I would like to hear from you as to how or what approach you think would be appropriate, because there are several different ways we can proceed. I'm not a cosponsor, I don't believe, of the 20 percent—I'm not sure you have to buy them all. I don't think I am.

Chairman SHAD. Your proposal would not require that the bidder buy all. The Commission's rules already require that if the bidder will own more than 5 percent, the bidder make the same offer to all. So your 20 percent would not-——

Senator METZENBAUM. Well, what I'm saying is over the recess, we will be drafting a tender offer reform measure. I hope to work with Senators Chafee, Specter, Lautenberg, D'Amato.

Senator D'AMATO. I would hope, Senator, that you would give us the opportunity to hold those hearings. Of course, with all due deference, I've kept my commitment to you, I've held this hearing, so

we could at least begin to build that basis. I have indicated to you that as quickly as we possibly could, I would schedule more hearings. I've asked Chairman Garn to do that. And it would seem to me that in an orderly fashion it would at least allow us to digest the information we have asked for, then to hold those hearing, and I've indicated I would be prepared to hold extensive hearings and even undertake the—hopefully, the marking up of some legislation in this area. I would ask we go through that process first.

Senator METZENBAUM. I would say to my respective chairman that I'm less concerned about the extensive hearings. I do want to get all the facts in, but I also want to get some action before all the horses are out of the barn.

Senator D'AMATO. I hope I indicated that. This is not an endeavor to just put off indefinitely. I'd like to consider tender offers thoroughly but with more speed than we are accustomed to.

Senator METZENBAUM. All right. Let's go on with the other witnesses.

Senator D'AMATO. We have another panel. Chairman Shad, if you would like to stay—and we also have a vote at 4:45. We'd be delighted to have you take this in. If you'd like to make your depature, we understand.

Chairman SHAD. I'm looking forward to reading the formal testimony of the other witnesses.

Senator METZENBAUM. Let me thank you for your participation, your thoughtfulness, and also for your very understanding nature in allowing others to come before you.

Chairman SHAD. Thank you very much, Senator D'Amato, and Senator Metzenbaum, thank you.

Senator D'AMATO. I don't know how many of our panel have left.

Our third panel, Michael Klein and H. Wayne Howell, director, securities division, State of Georgia, president, North American Securities Administrators, accompanied by Orestes Mihaly, New York Attorney General's Office and Randall Schumann of Wisconsin, vice chairman of NASAA Tender Offer Committee.

STATEMENT OF H. WAYNE HOWELL, DIRECTOR, SECURITIES DIVISION, STATE OF GEORGIA, AND PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, ACCOMPANIED BY ORESTES MIHALY, FROM THE NEW YORK ATTORNEY GENERAL'S OFFICE, CHAIRMAN OF NASAA TENDER OFFER COMMITTEE, AND RANDALL SCHUMANN, OF WISCONSIN, VICE CHAIRMAN OF NASAA TENDER OFFER COMMITTEE

Senator D'AMATO. Mr. Howell, thank you for your patience. Why don't you summarize your testimony?

Mr. HOWELL. Thank you Senator D'Amato. It is a pleasure to be here.

The North American Securities Administrators Association [NASAA] sincerely appreciates the invitation extended through Senator Metzenbaum's office, Senator D'Amato's Securities Subcommittee, and the Senate Banking Committee, to provide testimony at today's hearing dealing with several important issues relating to tender offer practices and appropriate regulatory responses.

My name is Wayne Howell. I am the Georgia Securities Administrator and the current president of NASAA. With me today is Orestes Mihaly, from the New York Attorney General's Office, and Randall Schumann of Wisconsin, the chairman and vice chairman, respectively, of the NASAA Tender Offer Committee, and we would be pleased to respond to any questions after these prepared remarks.

NASAA is a 66-year-old association comprised of the securities administrators of the 50 States as well as the Canadian Provinces and Mexico. Our members are charged with the protection of public investors within their jurisdiction and most of the State administrators have seen first hand, and have had to deal with, tender offer abuses that affect their citizenry.

PROMOTE LEGISLATION TO ENSURE INVESTOR PROTECTION

Pursuant to its investor protection responsibilities, NASAA has sought to promote Federal legislation that will eliminate abuses in the tender offer process by both bidders and target companies to thereby ensure investor protection.

In furtherance of that goal, NASAA has gone on record in previous comment letters and testimony to congressional committees on the House side, supporting several specific amendments to the Federal tender offer regulatory scheme.

This association has previously stated that State securities administrators do not wish to widen their authority of their jurisdiction in this area. Rather, our concern is remedying the current problems and abuses in the tender offer area in the interest of public investors. It is also the view of NASAA that Federal legislation which remedies the interest of public investors, America's corporations that are currently engaged in a mass scramble for survival in the current acquisition mania and the securities marketplace whose integrity has been subverted by these abuses.

NASAA has specifically gone on record as being strongly in favor of legislation dealing with three of the issues that are to be considered in these hearings before this committee; namely, a prohibition against coercive two-tier tender offers providing the Securities and Exchange Commission and target company shareholders with an injunctive remedy to check the excesses of management's antitakeover actions, and an extension of the minimum tender offer period from 20 to 60 days.

Our prepared remarks do not address the issue of directors' ownership of shares, which has been extensively discussed here today. NASAA does not have a current position on this topic, but my personal opinion is that it is probably a matter for State corporation law or something to be considered by the exchange listing requirements.

With respect to the two-tier offer issue, the coercive nature of the two-tier offer has been well documented and discussed at length by commentators over the last 2 years. Its coercive nature is evident from its basic structure; namely, that it is almost foolhardy for a shareholder not to tender in the offer, particularly if it is the only tender offer on the table, and thus lose out on the first-tier premium if the offer is unsuccessful, thereby leaving a nontendering

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shareholder with shares entitled only to the lower second-tier price, or a reduced market price reflecting such second-tier price. The result of this bidding technique is to force stockholders into rush-to-judgment decisions with respect to offers that are often exceedingly complex, especially when the second tier of the offer is non-cash and difficult to evaluate, or when competing bids are involved.

It is significant to note that even the Securities and Exchange Commission's own Advisory Committee on Tender Offers recognized the coercive nature of two-tier offers and recommended a regulatory disincentive to such offers that would make the minimum offering period for tender offers for less than all shares approximately 2 weeks longer than the offering period for an offer for all shares.

That such a disincentive would significantly affect the prospects for the success of a two-tier offer is acknowledged by the comments in the Law Journal article, "The Review of Securities Regulation," April 18, 1984 edition, that was written by an attorney in one of the leading New York law firms specializing in tender offers.

The article points out on page 919 thereof and in footnote 8 that it is the combination of the timing advantage a bidder has in deciding when to commence an offer plus the short 20-day tender offer period currently allowed under Federal law that allows the two-tier offer to be so successful in coercing tenders of target company shares in two-tier offers.

The article also underscores the coercive nature of two-tier offers by showing that such offers are highly successful under nearly every fact scenario. It is hard to escape the conclusion that this bidding technique is coercive when it is shown to be successful in nearly every fact situation, even where a target company has standard antitakeover defenses in place and a "White Knight" at its side.

The two-tier bidding technique, whose success relies on its coercive nature that is based on surprise and the ability to complete the tender offer transaction within the short 20-day period currently allowed under the Federal tender offer regulations, is totally at odds with the free market concept of "willing buyer/willing seller," the premise and foundation of the national securities markets which the Securities and Exchange Commission has a mandate to foster and protect.

Consequently, in the interests of investor protection and protecting the integrity of the securities marketplace, two-tier offers should be deemed, per se, manipulative under the Federal securities laws. As such, they should either be prohibited directly or the "20-percent threshold" proposal; that is, Senator Specter's proposal in S. 2448, should be adopted that would effectively curtail two-tier offers.

In that regard, with the advent of the Securities and Exchange Commission recently seeking comments on two-tier offers and with the current composition of the Commission having an opportunity to view these issues afresh, NASAA is hopeful that the current Commission will conclude that coercive two-tier offers that stampede investors into hasty and often less than fully informed decisions have no place in a national securities marketplace that the Commission is under a mandate to keep orderly. NASAA has noted

with interest recent remarks by two members of the Commission that have been published in the last 2 weeks in which they have expressed concerns with respect to two-tier and partial tender offers.

THE EFFECTIVENESS OF THE 10-PERCENT THRESHOLD LEVEL

As far as eradicating two-tier offers, the Metzenbaum amendment at the 20-percent level would accomplish that result. An even more effective step, one that NASAA has advocated in support of legislation on the House side in H.R. 5694 and which Senate Securities Subcommittee Chairman D'Amato introduced in S. 2783, would be a 10-percent threshold level which in one single and effective action would eliminate the three worst areas of shareholder abuse caused by bidder practices; namely, not only coercive two-tier offers, but also so-called greenmail repurchases of bidder shares by target companies, and so-called creeping tender offers. A 10-percent threshold proposal would effectively discourage greenmail and creeping tender offers because bidders would be precluded from assembling more than 10 percent of a target's shares to use to either coerce management into repurchasing the shares or as a springboard to a formal tender offer.

Turning to the second issue we would like to comment on, NASAA has gone on record in support of a House-sponsored proposal in H.R. 5695 that parallels the concept in Senator Chafee's amendment which would allow target company shareholders and the Securities and Exchange Commission to seek injunctive relief from harmful defensive tactics by management in takeover situations.

Senator D'AMATO. You really support that?

Mr. HOWELL. Yes, sir.

Senator D'AMATO. Even after you heard Senator Chafee indicate he had grave reservations and that you would open up an era of litigation that would be second to none with respect to corporate actions and activities?

Is your group mostly attorney generals, et cetera?

Mr. HOWELL. It is mostly attorney generals and other securities administrators.

Senator D'AMATO. I would hope you would bring it back to them and have them study that because if they like a lot of litigation and want to bog down the courts that is exactly what they are going to get, and not only bog down the courts but you will make it a wonderful delight for lawyers.

I can't seriously think that your entire committee that reviews legislative proposals has closely and seriously examined that legislative proposal, which I think Senator Chafee has put forth here for the purposes of some discussion and review.

But we will take that up.

Mr. HOWELL. We will take a look at that, Senator.

Senator D'AMATO. I would appreciate that.

Mr. HOWELL. With regard to Senator Metzenbaum's amendment proposal to extend the minimum tender offer period from 20 to 60 days, NASAA strongly supports it and urges that the Federal tender offer regulatory scheme be amended by Congress in statute

form to require that tender offers remain open for a minimum 60-day period.

This same proposal was recommended by several witnesses, including economists, academics, prominent investment bankers, and this association in testimony at congressional hearings earlier this year on the House side.

The current 20-business day offering period provision under Federal law, which translates into from 26 to 28 calendar days, is inadequate to allow dissemination and disclosure of information and opportunity for action by nonprofessional investors, especially where multiple competing bids are involved. Requiring tender offers to remain open for at least 60 calendar days would balance the element of surprise favoring a bidder, with the ability of a target company to take defensive actions that are prudent to the company and fair to shareholders. Additional time also permits greater opportunity for competing bids to develop. In competing bid situations, target company shareholders benefit from the higher prices which result from the auction process.

There is no sound public policy reason to conclude that bidders are entitled by some inalienable right, to the 20-business day period currently provided under Federal law, to acquire the control of a corporation whose business, products, management, shareholders, and employees may have developed over decades.

Indeed, the SEC's own Advisory Committee on Tender Offers specifically stated there is insufficient basis for concluding that takeovers are per se beneficial to the economy, securities markets, issuers, or their shareholders. Further, prescribing a 60-day minimum offering period cannot be considered radical legislation.

Such an amendment would act merely to provide a reasonable extension of the tender offer period. The benefits would be immediate and significant in the following respects: Such an extension would eliminate many of the abusive defensive tactics by management that are simply efforts to buy time, and such an extension would prevent bidders from pressuring corporate managers and shareholders into making hasty and confused decisions.

The time constraints within which a tender offer can be made or consummated are exclusively a legislative decision which should be made by Congress and not left to SEC rulemaking.

In a different regulatory context, Congress has already established under the Hart-Scott-Rodino Act that determinations in antitrust situations must be conducted over a substantial period of time in order for the interests of the public to be fully considered.

THREE REASONS FOR A 60-CALENDAR-DAY PERIOD

For the above reasons, changing the current 20-business day Federal regulatory scheme to a 60-calendar-day period is necessary in the public interest.

The hearings before the full committee represents a critical opportunity to focus attention on needed changes in the Federal regulatory scheme that would do the following:

One, prohibit coercive two-tier offers.

Two, provide shareholders an effective remedy to check the excesses of target company defensive tactics, and

Three, extend the minimum tender offer period to 60 days.

It is NASAA's view that these are key elements which are necessary to achieve a comprehensive and effective legislative package to remedy abusive practices by both bidders and target company management, and should not be blocked by special interest representatives favoring either bidders or target company management.

That concludes my prepared remarks. I again thank the committee for this opportunity to present NASAA's views on these important issues, and we would be pleased to respond to any questions you may have.

Senator D'AMATO. We thank you for your patience and for your prepared remarks and your efforts to improve the situation.

Senator Metzenbaum, do you have any questions?

Senator METZENBAUM. No. I think there is another witness.

Senator D'AMATO. Is there another witness? No. Mr. Klein, I believe, had to leave during the recess. They advised me so.

His testimony, as well as all the other witnesses, will be entered into the record.

[The complete statements follow:]

North American Securities Administrators Association, Inc.

1983-84 Officers/Directors

President
MICHAEL UNGER
Director
Massachusetts Securities Division
One Ashburton Place
Boston, Massachusetts 02108

Vice President
H. WAYNE HOWELL
Director
Georgia Securities Division
2 Martin Luther King, Jr. Drive
Suite 802, West Tower
Atlanta, Georgia 30334

Secretary
RICHARD R. MALMGREN
Commissioner of Securities
P.O. Box 1768
Madison, Wisconsin 53701

Treasurer
ROLAND COTE
Vice-President
Commission des valeurs mobilières du Québec
P.O. Box 246, Stock Exchange Tower
Montréal, Québec, H4Z 1G3, Canada

Directors

Richard D. Latham
Securities Commissioner
P.O. Box 13167, Capitol Station
Austin, Texas 78711

E. C. "Al" Mackey
Department of Commerce
Corporations & Securities Bureau
6546 Mercantile Way
Post Office Box 30222
Lansing, Michigan 48909

Orestes J. Mihaly
Assistant Attorney General
in Charge
Bureau of Investor
Protection & Securities
Department of Law
2 World Trade Center
New York, New York 10047

Abner W. "Buster" Sewell
Deputy Secretary of State
Department of State
Securities Division
State Capitol, Capitol Complex
Carson City, Nevada 89710

R. G. "Rick" Tucker
Chief Deputy
Securities Commissioner
Securities Department
Mitchell Building
P.O. Box 4009
Helena, Montana 59604

Executive Secretary
Bruce Burdett
2930 S.W. Wanamaker Dr., Suite 5
Topeka, Kansas 66614
(913) 273-2600

OCTOBER 2, 1984

STATEMENT ON BEHALF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. (NASAA) BEFORE THE SENATE BANKING COMMITTEE

BY H. WAYNE HOWELL
NASAA PRESIDENT

The North American Securities Administrators Association, Inc. ("NASAA") sincerely appreciates the invitation extended through Senator Metzenbaum's office, Senator D'Amato's Securities Subcommittee and the Senate Banking Committee, to provide testimony at today's hearing dealing with several important issues relating to tender offer practices and appropriate regulatory responses.

My name is Wayne Howell. I am the Georgia Securities Administrator and the current President of NASAA. With me today is Orestes Mihaly of New York and Randall Schumann of Wisconsin, the Chairman and Vice-Chairman, respectively, of the NASAA Tender Offer Committee, and we would be pleased to respond to any questions after these prepared remarks. NASAA is a sixty-six year old association comprised of the securities administrators of the fifty states as well as the Canadian Provinces and Mexico. Our members are charged with the protection of public investors within their jurisdiction and most of the state administrators have seen first hand, and have had to deal with, tender offer abuses that affect their citizenry.

Pursuant to its investor protection responsibilities, NASAA has sought to promote federal legislation that will eliminate abuses in the tender offer process by both bidders and target companies to thereby ensure investor protection.

In furtherance of that goal, NASAA has gone on record in previous comment letters and testimony to Congressional committees on the House side, supporting several specific amendments to the federal tender offer regulatory scheme. This Association has previously stated that state securities administrators do not wish to widen their authority or their jurisdiction in this area. Rather, their concern is remedying the current problems and abuses in the tender offer area in the interest of public investors. It is also the view of NASAA that federal legislation which remedies the most serious of the tender offer abuses is in the best interest of public investors, America's corporations that are currently engaged in a mass scramble for survival in the current acquisition mania, and the securities marketplace whose integrity has been subverted by these abuses.

NASAA has specifically gone on record as being strongly in favor of legislation dealing with three of the issues that are to be considered in these hearings before this Committee--namely: (1) a prohibition against coercive "two-tier" tender offers; (2) providing the Securities and Exchange Commission and target company shareholders with an injunctive remedy to check the excesses of management's anti-takeover actions; and (3) an extension of the minimum tender offer period from 20 days to 60 days.

Two-Tier Offers

With respect to the two-tier offer issue, the coercive nature of the two-tier offer has been well documented and discussed at length by commentators over the last two years. Its coercive nature is evident from its basic structure--namely, that it is almost foolhardy for a shareholder not to tender in the offer (particularly if it is the only tender offer on the table) and thus lose out on the first tier premium if the offer is successful, thereby leaving a non-tendering shareholder with shares entitled only to the lower second tier price (or a reduced market price reflecting such second tier price). The result of this bidding technique is to force stockholders into rush-to-judgement decisions with respect to offers that are often exceedingly complex--especially when the second tier of the offer is non-cash and difficult to evaluate, or when competing bids are involved.

It is significant to note that even the Securities and Exchange Commission's own Advisory Panel on Tender Offers

recognized the coercive nature of two-tier offers and recommended a regulatory "disincentive" to such offers that would make the minimum offering period for tender offers for less and all shares approximately two weeks longer than the offering period for an offer for all shares. That such a disincentive would significantly affect the prospects for the success of a two-tier offer is acknowledged by the comments in the attached law journal article The Review of Securities Regulation, April 18, 1984 edition, that was written by an attorney in one of the leading New York law firms specializing in tender offers. The article points out on page 919 thereof and in footnote 8 that it is the combination of the timing advantage a bidder has in deciding when to commence an offer plus the short twenty-day tender offer period currently allowed under federal law that allows the two-tier offer to be so "successful" in "coercing" tenders of target company shares in two-tier offers. The article also underscores the coercive nature of two-tier offers by showing that such offers are highly successful under nearly every fact scenario. It is hard to escape the conclusion that this bidding technique is coercive when it is shown to be successful in nearly every fact situation,even where a target company has standard anti-takeover defenses in place and a "White Knight" at its side.

The two-tier bidding technique, whose success relies on its coercive nature that is based on surprise and the ability to complete the tender offer transaction within the short twenty-day period currently allowed under the federal tender offer regulations, is totally at odds with the free market concept of "willing buyer-willing seller"--the premise and foundation of the national securities markets which the Securities and Exchange Commission has a mandate to foster and protect.

Consequently, in the interests of investor protection and protecting the integrity of the securities marketplace, two-tier offers should be deemed per se' manipulative under the federal securities laws. As such, they should either be prohibited directly or the "20% threshold" proposal should be adopted that would effectively curtail two-tier offers.

In that regard, with the advent of the Securities and Exchange Commission recently seeking comments on two-tier offers and with the current composition of the Commission having an opportunity to view these issues afresh, NASAA is hopeful that the current Commission will conclude that coercive two-tier offers that stampede public investors into

hasty and often less-than-fully-informed decisions have no place in a national securities marketplace that the Commission is under mandate to keep orderly. NASAA has noted with interest recent remarks by two members of the Commission that have been published in the last two weeks (see attached) in which they have expressed concerns with respect to two-tier and partial tender offers.

As far as eradicating two-tier offers, the Metzenbaum amendment at the 20% level would accomplish that result. An even more effective step, one that NASAA has advocated in support of legislation on the House side in H. R. 5694 and which Senate Securities Subcommittee Chairman D'Amato introduced in S. 2783, would be a 10% threshold level which in one single and effective action would eliminate the three worst areas of shareholder abuse caused by bidder practices--namely, not only coercive two-tier offers, but also so-called "greenmail" repurchases of bidder shares by target companies, and so-called "creeping" tender offers. A ten percent threshold proposal would effectively discourage "greenmail" and "creeping" tender offers because bidders would be precluded from assembling more than 10% of a target's shares to use to either coerce management into repurchasing the shares or as a springboard to a formal tender offer.

Injunctive Authority to Shareholders and the Securities and Exchange Commission

Turning to the second issue we would like to comment on, NASAA has gone on record in support of a House-sponsored proposal in HR 5695 that parallels the concept in Senator Chafee's amendment which would allow target company shareholders and the Securities and Exchange Commission to seek injunctive relief from harmful defensive tactics by management in take over situations.

The proposal would require the management of a target company not only to satisfy the business judgement rule, but also to show that a defensive anti-take-over tactic was prudent for the issuer and fair to shareholders. The proposal would provide the shareholders of a target company, as well as the Securities and Exchange Commission, with an effective and timely mechanism to call target company management "on the carpet" to establish certain defensive maneuvers against a tender offer were both prudent for the company and fair to the company's shareholders. The proposal

would provide that such will be done in a forum--a court proceeding--where the issues can be fully presented and discussed and where effective action can be taken by injunctive other appropriate remedy before the shareholders of the target are left with a crippled company that may no longer be financially or economically viable--a result disastrous to shareholders, the company's employees, the local community the company serves, and the economy. Such a proposal would be fair in its coverage since in connection with any court proceeding regarding the defensive tactics, management would not be liable if it could show that its actions met not only the business judgement rule, but also the test of being prudent to the company and fair to shareholders.

Responsible corporate managers who undertake defensive actions in the face of a tender offer should not fear such legislation where their motivations are truly focused on the best interests of the company and its shareholders.

Extending the Tender Offer Period form 20 to 60 days

With regard to Senator Metzenbaum's amendment proposal to extend the minimum tender offer period from 20 to 60 days, NASAA strongly supports it and urges that the federal tender offer regulatory scheme be amended by Congress in statute form to require that tender offers remain open for a minimum 60 day period. This same proposal was recommended by several witnesses including economists, academics, prominent investment bankers and this Association in testimony at Congressional hearings earlier this year on the House side.

The current 20 business day offering period provision under federal law (which translates into from 26 to 28 calender days) is inadequate to allow dissemination and disclosure of information and opportunity for action by non-professional investors, especially where multiple competing bids are involved. Requiring tender offers to remain open for at least 60 calendar days would balance the element of surprise favoring a bidder, with the ability of a target company to take defensive actions that are prudent to the company and fair to shareholders. Additional time also permits greater opportunity for competing bids to develop. In competing bid situations, target company shareholders benefit from the higher prices which result from the auction process.

There is no sound public policy reason to conclude that bidders are entitled to some inalienable right, in the 20 business day period currently provided under federal law, to acquire the control of a corporation whose business, products, management, shareholders and employees may have developed over decades. Indeed, the Securities and Exchange Commission's own Advisory Panel on Tender Offers specifically stated there is insufficient basis for concluding that takeovers are per se beneficial to the economy, securities markets, issuers or their shareholders. Further, prescribing a 60-day minimum offering period cannot be considered radical legislation. Such an amendment would act merely to provide a reasonable extension of the tender offer period. The benefits would be immediate and significant in the following respects: (a) such an extension would eliminate many of the abusive defensive tactics by management that are simply efforts to "buy time"; and (b) such an extension would prevent bidders from pressuring corporate managers and shareholders into making hasty and confused decisions.

The time constraints within which a tender offer can be made or consummated are exclusively a legislative decision which should be made by Congress and not left to SEC rule-making. In a different regulatory context, Congress has already established under the Hart-Scott-Rodino Act that determinations in anti-trust situations must be conducted over a substantial period of time in order for the interests of the public to be fully considered. For the above reasons, changing the current 20 business day federal regulatory scheme to a 60 calender day period is necessary in the public interest.

This hearing before the full Committee represents a critical opportunity to focus attention on needed changes in the federal regulatory scheme that would do the following: (1) prohibit coercive two-tier offers; (2) provide shareholders an effective remedy to check the excesses of target company defensive tactics; and (3) extend the minimum tender offer period to 60 days. It is NASAA's view that these are key elements which are necessary to achieve a comprehensive and effective legislative package to remedy abusive practices by both bidders and target company management, and should not be blocked by special interest representatives favoring either bidders or target company management.

That concludes my prepared remarks. I again thank the Committee for this opportunity to present NASAA's views on these important issues, and we would be pleased to respond to any questions you may have.

corporation, but management claimed it could vote all the stock. And it was all done with notes. The sole purpose clearly was entrenchment, because it was not a case of management going out and looking for another offer or a white knight.

The *Norlin case* is in contrast to a situation where a company issues shares to a white knight to induce them to come into the takeover fight, or maybe does other things that would be characterized as extreme. Management, nonetheless, is out there trying to get a better offer for the shareholders. I don't read *Norlin* as saying that type of situation is bad. It's interesting to read *Norlin*; obviously there's a line you can cross over. But that's a pretty fact-intensive case, with fairly extreme facts. I don't jump to the conclusion that it presages any vast rewriting of the business judgment rule.

For example, there's a decision handed down last March by the Delaware Supreme Court, *Aronson v. Lewis* [16 SRLR 480], which one of my acquaintances in the Delaware bar characterizes as "making the business judgment rule bomb proof." So, it's kind of hard to go too far or get too carried away about the impact of *Norlin*.

Tender Offer Regulation

Q: When you appeared before the National Association of Manufacturers, you were critical of the recommendations by the SEC Advisory Committee on Tender Offers that intruded on state rights [16 SRLR 468]. Why do you strongly object to federal intrusion into areas traditionally regulated by the states?

A: Because I'm a traditional lawyer. That's a part of our federal system of laws, and before the federal government goes barging into state law and attempting to preempt state law on any broad basis, we just better be darn sure that the tradeoff is there. The issue was at the time whether we were to say, for example, that all golden parachutes were bad, and to say that it's such an abuse that the federal government has got to go in and preempt state law. There are inconsistencies between federal and state law and there is a lack of uniformity. But that is one of the strengths of our legal system. It is not something to apologize for.

Sure, it does produce inconsistent results. You have inconsistent results from state to state, not only federal versus state. You have a course in law school called "conflicts of law" where you decide which law applies. I am quite skeptical whether the case has been made that some of the tactics that the tender offer advisory committee wanted to outlaw, that would involve preemption, are that bad.

We had three of those tactics come up, and the Commission decided to seek legislation to deal with those issues. I voted against one of those, which was the question of the target issuing additional shares in the face of a tender offer. I voted for restrictions on golden parachutes and greenmail. But I must tell you that I did that with many, many reservations, and if the issue were put to me again, I'm not sure I would vote the same way.

Q: Would you object strongly to creating a federal right of action in tender offers, such as Sen. John Heinz (R-Pa) proposed with regard to greenmail [16 SRLR 1066]?

A: If you create a federal right without preempting state law, you are just layering it on top of existing law, and that's conceptually less offensive. That concept is different from a preemption concept.

Q: It seems that Congress will not enact legislation this year in the area of takeover abuses. If it becomes clear that legislation will not be forthcoming, would you like the Commission to go back and examine other areas where rulemaking could resolve some perceived problems, instead of waiting for Congress?

A: We'd have to cross that bridge when we got there, and see why it broke down. As long as there is something pending, it's alive legislatively. It would not be politically wise or feasible for the Commission to hop in and try to do our own preemption by rulemaking. That's not the way the system ought to work.

If there are problem areas and legislation completely dies, with no prospects for being reintroduced, the Commission should go back and look at the whole tender offer area. We would be in the position to do that, and we started this ball rolling in this area.

The Commission really ought to deal with the issue of two-tier and partial tender offers and we have a concept release out [16 SRLR 1100]. I obviously will review the comments as they come in with an open mind, but I'm not sure we are going to hear anything else new on the issue. I know what the arguments are on both sides. Unless somebody can persuade me otherwise, I have a strong predilection to want to do something.

Leveraged Buyouts

Q: Turning to leveraged buyouts, Bevis Longstreth, when he was a commissioner, spoke out against the buyouts, saying there is evidence of abuses. As a private citizen, he has complained that the SEC's rules have put the Commission's imprimatur on the transactions. Do you have concerns that leveraged buyouts are being abused, and do you feel the Commission should be reviewing its regulation of the buyouts?

A: There seems to be a perception in the minds of some people that the Commission doesn't regulate leveraged buyouts, but it does. Most leverage buyouts are in fact a form of "going private." And you've got Rules 13(e)-3 and 13(e)-4 that deal with this area. Rule 13(e)-3 deals with the issue quite extensively. The rule is, among other things, an attempt to bring procedural fairness into these transactions. Now, even before I came to the Commission there was a debate as to whether the Commission could go further and create a substantive fairness standard in these transactions.

At the time the rule was adopted, a decision was made that the Commission can put in a lot of procedures, set up a lot of hoops for people to jump through, set out a lot of specific disclosures that explain the whys and wherefores — how you did the evaluation, who did it, and what the conflicts are. But unless you're willing to go a step further and seek some federal standard of substantive fairness, the regulation is there. It's essentially a disclosure regulation. It

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However, he expressed concern that RICO's treble damages provision could undermine "carefully crafted structures" of express and implied remedies under state and federal securities statutes. RICO allows private plaintiffs to recover treble damages where the federal securities laws expressly limit recovery to actual damages, he noted.

The "implicit unfairness" of RICO, however, is that the statute "metamorphosizes a laundry list of laws which require indictment by a grand jury and proof beyond a reasonable doubt into civil violations actionable under RICO by lumping them together under the rubric 'pattern of racketeering' activity." RICO stands a long history of criminal and civil remedies "on its head," Marinaccio charged.

Second Circuit Trilogy

He drew attention to the recent trilogy of RICO-limiting opinions handed down by the U.S. Court of Appeals for the Second Circuit (16 SRLR 1280, 1282, 1283). The Second Circuit's restrictive reading of the statute "results from a very careful analysis of the congressional purpose" behind RICO, he said. However, he noted that the rulings are not controlling in other circuits and actually conflict with some circuits.

Private plaintiffs will "continue to use RICO's civil right of action to alter significantly the balance of rights and remedies established by the securities and other laws," he predicted. Congress must revisit the statute, he asserted, and make clear that "before a civil claim may be filed under RICO the predicate of a criminal charge by the government is a necessity." In addition, Congress should make it clear that a "'racketeering' type injury needs to be shown."

Marinaccio suggested that "[p]erhaps the Supreme Court will do the job" of restricting RICO, but he concluded that it is the responsibility of Congress to eliminate abuses of the statute.

Tender Offers

Turning to a different policy consideration, Marinaccio took issue with some of the proposals in pending legislation and in the report of the SEC Advisory Committee on Tender Offers. He expressed concern that suggested changes in the business judgment rule could "alter historical federal-state relationships."

There has been a great deal of criticism of the role of incumbent management in hostile takeover situations, he noted. The assumption implicit in the criticism is that management looks out for itself in tender offers, rather than for the shareholders.

In response, the SEC advisory committee recommended preemption of the business judgment rule in some areas and the SEC drafted legislation that would limit management's ability to determine executive compensation and "corporate issuances and purchases of its securities in some takeover circumstances." There are bills in Congress to adopt those positions and others, including "a wholesale assault on the business judgment rule to require management to prove the reasonableness of its actions in a hostile tender offer" and to require bidders to file community impact statements (HR 5693), he said. The SEC opposes that bill (16 SRLR 1473).

"Wholesale Federalization"

"Taken as a whole these recommendations, if adopted, would be tantamount to a substantially wholesale federalization of state corporate law," he asserted. There have been abuses, he conceded, noting as an example that greenmail "is indefensible." However, state corporate law should not be supplanted by federal law. Federal policy should not favor hostile takeovers by preempting state laws that are viewed as impediments to takeovers, he said.

He noted that his view is that hostile tender offers should not be outlawed. However, he added, there are potentially serious abuses that should be addressed, abuses that may exist outside the hostile tender offer area, but that are more "troublesome in the hostile context."

The two areas he focused on are (1) the 10-day window that exists between the time a bidder acquires at least 5 percent of a target's stock and the time notice must be filed with the SEC and (2) two-tier tender offers. There "appears to be an emerging consensus" that the 10-day window should be closed, he said, but there is no consensus on how to deal with the two-tier tender offer problem.

Two-tier offers "appear at first blush to be fundamentally unfair to shareholders," Marinaccio said. Potential solutions to the two-tier pricing problem are complex, he noted, but "it appears to me that the burden is on those who favor two-tier pricing to prove that public policy is best served in this instance by non-compliance with the spirit of the best price rule under the Williams Act."

RULE 415 STOCKS PERFORM POORLY, LOSSES EXCEED COST SAVINGS, STUDY SAYS

Prices of stock offerings registered under the Securities and Exchange Commission's shelf registration rule, Rule 415, are significantly worse than the market prices of nonshelf issues around the announcement date of the offering, according to a study circulated by the Securities Industry Association.

Losses Exceed Savings

While shelf registration lowered the cost of issuing an offering, the negative performance of stock prices of shelf issues "was four to 12 times greater than the savings in issuance costs," the study says. It was prepared by Gary Grey, an E.F. Hutton vice president, for a Pennsylvania State University doctoral dissertation.

The SEC adopted Rule 415 on a permanent basis in November 1983 (15 SRLR 2123) after an 18-month trial. The rule allows the most widely followed corporations to register a stock offering and then sell the stock on a delayed or continuous basis. With a single registration statement, a company can sell stock for up to two years and take advantage of favorable market conditions or interest rates.

At the time the Commission was considering whether to make Rule 415 permanent, the SEC Office of the Chief Economist issued a memorandum that said the

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THE REVIEW OF
SECURITIES REGULATION
An analysis of current laws and regulations affecting the securities industry

PUBLISHED BY STANDARD & POOR'S CORPORATION

Vol. 17, No. 8 April 18, 1984

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TENDER OFFER BIDDING STRATEGY

In Contested Takeovers, Certain Properly Constructed Two-Tier Bids Have Advantages Over Single Bids at the Same Average Price. Despite Conventional Wisdom, Their Advantages May Be Enhanced by Stock Lock-Ups for a Competing White Knight.

By Lawrence Lederman*

Pricing and proration decisions are central to tender offer strategy. The proration rules were changed at the end of 1982.[1] It is appropriate to examine the strategic use of these and the other the tender offer rules, to assess the strengths and weaknesses of partial bids compared with bids for all shares, and to reassess the effectiveness of two-tier bids.[2] Since the use of options or contracts to purchase outstanding shares from principal shareholders and authorized and unissued shares of target companies has become prevalent,[3] their effect on the bidding process will also be reviewed. Moreover, the change in the third-party partial bid rules concerning proration requirements, in the absence of a comparable change in the self-tender rules,[4] requires consideration of the strategic use of the self tender in competing bid situations.

This article concludes that despite the change in the proration rules, the two-tier bid is still the most effective. A properly constructed two-tier bid, initiated by a raider, has a timing advantage and can win against an offer for all shares at the same, or even a higher, weighted average price. Moreover, properly constructed two-tier bids blunt the effectiveness of options to purchase stock and other stock lock-up devices, where control is not obtained. In that case, contrary to common belief, lock-ups of stock often impede rather than advance the cause of white knight bidders. Moreover, while "fair price" provisions in certificates of incorporation have proliferated to impede or discourage two-tier bids, such

*LAWRENCE LEDERMAN is a member of the New York City law firm of Weichell, Lipson, Rosen & Katz. He gratefully acknowledges the assistance of Georgina Wertman and Eric Robinson, associates of the firm, in the preparation of this article.

1 Rule 14(d)(8) of the Exchange Act provides that the period during which shares must be taken up and paid for pro rata lasts as long as the tender offer remains open, including extensions, notwithstanding section 14(d)(6) of the Exchange Act, which limits the pro-rata period to 10 calendar days. The discussion of the proration rules and the comments requested by the SEC when it considered changing the proration rules were initiated in part by Lederman and Vlahakis, "*Pricing and Proration in Tender Offers*," Rev. Sec. Reg., Vol. 14, No. 20.

2 Partial bids are tender offers for less than all of the outstanding shares. They require proration if more shares are tendered than were sought in the tender offer. The partial tender offer may or may not contemplate a follow-up merger transaction for securities or cash. Two-tier bids (sometimes referred to as front-end-loaded bids) are partial bids in which the tender offer is higher than the price, in cash or securities, to be offered in the follow-up merger.

3 "Lock-up" devices with respect to shares to the actual purchase, an option, or an executory contract to purchase shares from certain principal shareholders, treasury, or authorized and unissued shares from the company. The New York Stock Exchange limits purchases to 18½% of the outstanding shares from the company without shareholder approval, otherwise there is theoretically no limitation, up to the authorized capital of the company. See *Data Probe Acquisition Corp. v. Datatab, Inc.*, [Current] CCH ¶99,569 (2d Cir. 1983).

4 Self tenders are governed by rule 13(e)(4) of the Exchange Act. Self tender offers require shorter withdrawal and proration than third-party tender offers, as described in the text. The Commission has stated, in response to the Report of the SEC's Advisory Committee on Tender Offers, that "... defensive issuer tender offers should be prohibited," and the SEC intends to propose appropriate legislation. Statement of Chairman Shad, in Hearings of the House Subcommittee on Telecommunications, Consumer Protection and Finance, [Current] CCH ¶83,511 at 86,683 (referred to herein as the "SEC Response to the Committee Report").

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provisions are unlikely to discourage a two-tier bid by a well-financed and determined bidder.

The pricing and proration decisions available to a bidder for control of a public company and the strategic use of the tender offer rules are illustrated in the following case models. The acquiring company will be referred to as Raider, the subject company as Target, and the third-party bidder as White Knight.

CASE A: THE TWO-TIER TAKEOVER BID

On June 1, 1984, Raider commences a tender offer for 1,425,000 shares of the 3,000,000 shares outstanding of Target (47.5%), reserving the right to take up to 1,750,000 shares. At the commencement, Raider holds 150,000 (5.0%) of Target's shares. Management holds an aggregate of 450,000 shares (15%). Before the tender offer Target stock was trading at $15 a share. Raider offers $30 a share in cash and states that in the second-step merger transaction, which is to follow the tender offer, $20 in market value of securities (probably common stock) will be offered. The two-tier bid has a weighted average (or blended) value of $25 a share, assuming a real value of $20 for the securities offered in the second step. We will assume that neither bidder will be subject to a second request under the Hart-Scott-Rodino Act and that each will be free to purchase shares in the minimum time periods, after 15 business days for an offer for all shares, and after 20 business days for a partial offer.

It takes Target approximately 15 calendar days to find a White Knight. The White Knight is prepared to pay $28 a share cash for all shares. It takes White Knight and Target five calendar days to work out all contractual arrangements, prepare the tender offer papers, and commence the offer. White Knight sets as a condition to its bid that it acquire at least 1,500,000 shares before it will be obligated to purchase any shares.

White Knight has commenced a timely, superior offer—a $28-per-share offer against a $25-per-share (blended price) offer. We will assume that the transaction has experienced significant market activity, reflecting the accumulation of stock positions by market arbitrageurs. Assuming no increase in the price offered by either bidder, which will win?

CASE A: ANALYSIS

The following facts are known: Raider's proration and expiration date was midnight, June 28 and its withdrawal date was midnight, June 21. White Knight's bid on June 20 has extended Raider's withdrawal, proration, and expiration dates until midnight, Thursday, July 5, 1984, ten business days after White Knight's commencement. Raider will be free to pay at 12:01 A.M. on Friday, July 6, 1984. White Knight's withdrawal date is midnight, July 11, 1984 and its expiration date is midnight, July 18, 1984. White Knight can pay at 12:01 A.M., July 12, 1984. Raider can thus pay six days earlier than White Knight.[5]

Although White Knight has made the higher bid for all the shares, Raider is in a position to win. To those shareholders willing to take a chance, Raider offers the opportunity to sell their shares at $30 a share. The market professionals (arbitrageurs) can assume that the 15% of the shares held by Target management and the 5% held by Raider will not be tendered. In addition, approximately 10% of the outstanding shares probably will not be tendered.[6] Furthermore, the confusion caused by White Knight's "higher" bid (for all shares) is likely to increase the number of shares that will not be tendered to Raider. Since no minimum number of shares need be tendered, if the offer is undersubscribed all shares tendered will be purchased at $30. The downside risk for the arbitrageurs would be a blended price of $26.79 (to be discounted slightly for the time to realize the $20 in the second step), in the unlikely event that all available shares (70% of those outstanding) are tendered to Raider.

One major risk for arbitrageurs is that if less than 50% of the outstanding shares are tendered to Raider, Raider's tender offer may be extended. If the extension goes beyond July 5, 1984 (the withdrawal deadline), shareholders who tendered will not be able to withdraw their shares, and additional shares are likely to be tendered during the extension, increasing the risk of adverse proration to tender-

5 If Raider changes its price, the change affects the number of days the offer must be open (at least 10 business days from the time of a price change), and Raider faces the possibility of a later expiration date than that of White Knight.

6 The percentage varies, depending on how heavily the matter is contested. For the purpose of illustration, the 10% figure will be used in all examples.

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ing shareholders. To encourage the arbitrageurs and others to tender, by eliminating that risk, Raider announces before its offer expires that, if the offer is extended, withdrawal rights will be available until its expiration. An extension will require announcement of the number of shares tendered and permit an informed decision by the arbitrageurs.

Raider's bid is well priced. If its offer is oversubscribed at the expiration date, it can accept shares for purchase, which terminates withdrawal rights, and thereby win the contest for control. If Raider's offer is undersubscribed, it has three choices, without directly increasing the price (under rule 14e-1(b), a price increase would extend the offer for ten business days from the increase): (1) extend its offer to attract more shares, (2) extend the offer and increase the number of shares sought (which has the effect of increasing the price without triggering rule 14e-1[7]—1,750,000 shares at $30 amounts to a blended price of $28.33 for the 70% who tender, a winning bid), or (3) terminate the offer after purchasing any tendered shares and purchase one or two blocks at prevailing prices, which may be less than the $30 that was paid in the tender offer, without proration, to attract the necessary shares.

The analysis reveals that $28 for all shares, while a superior economic bid for the entire transaction, was a poor pricing and bidding decision. Raider remains in a position to win the bidding, thanks to its timing and pricing decision. Raider had the advantage of initiating the transaction (an advantage inherent in being a raider under present rules), and of the two-tier bid structure.[8] The timing advantage—an extremely powerful strategic weapon, as further analysis will show—cannot be overcome by White Knight unless it commences a tender offer for all shares within four business days of the commencement of Raider's tender offer. That result is inevitable, given the requirement that Raider's partial offer must remain open for 20 business days before Raider can commence payment for shares, while White Knight's offer for all shares permits payment after the 15th business day. The fact that White Knight's bid under certain circumstances (illustrated in Case A) extends Raider's bid does not change the timing advantage. The analysis shows that two-tier bids remain an exceptionally effective technique in tender offer strategy.[9]

Ironically, management's strength, the 15% share position, has become a weakness for Target owing to a poor pricing decision, since management's commitment to White Knight not to tender to Raider enhances Raider's bid by significantly reducing the risk of proration to a shareholder tendering to Raider. Raider's two-tier bid can be seen as most coercive to Target's management. Management therefore has an enormous inducement—$8 per share—to see that White Knight's bid prevails.

The next question to consider is the effect on the bidding of the so-called lock-up options. These include options to purchase (1) the outstanding shares held by management and directors, (2) available authorized and unissued shares of Target (up to 18.5% of the outstanding shares under New York or 20% under American Stock Exchange rules), and (3) options to purchase certain discrete profitable assets or businesses, "crown jewels."

CASE B: WHITE KNIGHT COUNTER BID

The facts are as stated in Case A, except that management agrees to sell its 15% of the outstanding shares to White Knight and Target grants an option for 540,000 shares (18% of the outstanding) at $28 per share cash and a "crown jewel" option on a division. Assume that all the options will be sustained in court.[10]

CASE B: ANALYSIS

Management's grant of an option on its 15% of the outstanding shares has an effect no different from that in Case A, since those shares were presumed to be committed to White Knight. The increase in the contemplated outstanding shares affects Raider, but not adversely, as conventional wisdom would claim. In certain respects, Raider's bid is enhanced. Raider will have to purchase more shares (approximately 195,000 to obtain a majority giving effect to the 150,000 previously purchased), for Raider must assume that

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7 *McDermott, Inc. v. Wheelabrator-Frye, Inc.*, 649 F.2d 489 (7th Cir. 1980). The Commission has indicated, with respect to recommendation 18 of the Committee (that an increase in shares constitutes an increase in the offer price) that it will change the rule. See SEC Response to the Committee Report, supra, at 83,679-680.

8 Recommendation 16 of the Committee's Report would make the minimum offering period for a tender offer for less than all shares approximately two weeks longer than that for an offer for all shares. That would eliminate all timing advantage. The SEC has rejected such a change in the rules. See SEC Response to the Committee Report, supra, at 86,619.

9 The two-tier strategy, which requires a tender offer for less than all the outstanding shares, should not be misunderstood as a bid for some and not all shares. Raider's bid is for all shares of the Target company (for a price of $25 a share). There is no doubt that Raider has every intention of acquiring all the outstanding shares. Moreover, all shares and shareholders are permitted to participate in Raider's cash tender offer.

10 The Sixth Circuit would probably still consider lock-up options defective. See *Mobil v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981). But recent Second Circuit decisions expressly disapproved of *Marathon*, holding that the sale and option of treasury stock by a target to a potential White Knight was protected by the business judgment rule. See *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757 (2d Cir. 1983); *Data Probe Acquisition Corp. v. Datalab, Inc.*, supra. The Third Circuit has also recently disapproved of *Marathon*. See *Schreiber v. Burlington Northern, Inc.*, CCH ¶91,407 (3d Cir. April 2, 1984). The SEC in response to recommendation 41 of the Committee (which would approve options of up to 15%) takes the view that such options should not exceed 5%. See SEC Response to the Committee Report, supra, at 86,681.

the option will be exercised, although, as indicated below, it probably will not be. But the requirement that Raider purchase additional shares reduces the risk of adverse proration to tendering shareholders, and thereby encourages tenders by arbitrageurs. Raider can purchase additional shares at an attractive price: Its two-tier bid puts it in a position to buy the shares at a blended price of $25 a share, while the corporate treasury will, in all likelihood, be entitled to receive $28 for the shares to be purchased by White Knight. We can then assume that White Knight will not exercise its option, while, as indicated above, Raider must assume the exercise of the option.[11]

The "crown jewel" option may dissuade Raider from bidding because Target will lose a desirable asset, regardless of the price paid for exercising the option. Alternatively, the exercise price may fully compensate for the loss of the asset and Raider may not be deterred, or may, in some cases, be financed by the sale.[12] Under the present law, where the validity of the "crown jewel" option is uncertain,[13] granting the option affects pricing decisions. Assuming that exercise of the option would dissuade Raider from bidding for Target, Raider must challenge the option as chilling the bidding, and therefore manipulative. To strengthen its argument before the court, Raider should not be offering a blended price of $25 a share as against White Knight's $28 a share; in that situation it is hard to see that the shareholders were disadvantaged by the grant of the option and Raider's termination of bidding. Accordingly, uncertainty as to the validity of "crown jewel" options has a significant effect on the pricing decisions, probably causing Raider either to withdraw or to raise its bid (at least to the extent of matching White Knight's bid by acquiring more shares and going to a blended price of $28 a share, relying then on the timing advantage). The uncertainty in Raider's choice is only temporary, owing to uncertainty in the law. In time we will know whether or in what circumstances "crown jewel" options are valid. Then the effect of granting the option will depend largely on the assets, subject to the option, the price paid, and the attitude of Raider.

The analysis reveals that the stock lock-up devices that do not pass control to White Knight are not particularly effective at this round of bidding, at least when White Knight's offer is poorly structured. The benefit of lock-ups of stock comes in the next round of bidding (if there is one), based on the leverage of a fixed purchase price for the shares at $28 a share, when the bidding has escalated to a higher price. Shares can usually be purchased from the Target company at a fixed price (relative to the price offered for all shares by White Knight), but rarely will management agree to such pricing for their own shares. At a minimum, management will require that they get for their shares the highest price offered by White Knight. Therefore, it is only the option for authorized and unissued shares from Target that provides bidding leverage.

From a bidding perspective, the lock-up of management's stock provides at best a consolation prize if White Knight is outbid. The outbid White Knight, however, may not be able to realize any gain if the second step of a two-tier bid is lower than the price it paid. When more than 10% of the outstanding shares have been acquired through a number of purchases, the opportunity of tendering into Raider's offer will not be available to White Knight because of section 16(b) limitations (the short-swing profit rules under the Exchange Act). White Knight must look to the merger transaction to realize gain on shares purchased from management and from Target.[14] The interesting consequence of having to wait for the merger transaction to avoid short-swing profit liability is that with a two-tier bid, purchases of shares by White Knight may not offer any consolation prize, and therefore may not impede, in any economic sense, Raider's bid.

The next question is whether Raider's timing advantage, given the price that White Knight is prepared to pay (a blended price of $28 a share), is conclusive, or whether White Knight can restructure its bid to put itself in a winning position.

CASE C: WHITE KNIGHT'S TWO-TIER BID

White Knight responds with a two-tier bid. White Knight offers to purchase 1,500,000 shares at $36 a share, with the second-step merger to be $20-a-share cash for the remaining 1,500,000 shares, representing a blended price of $28 a share. White Knight receives an option to acquire 540,000 shares (18%) from Target at $28 per share and management's 15% stock ownership at $28 per share (or, if the

11 Raider must buy more shares than it needs. Target and White Knight can control the finish line and move it to Raider's disadvantage by increasing the number of shares required to be purchased. It is this aspect of the options that makes them manipulative.

12 Grand Metropolitan, in its tender offer for Liggett, faced the sale by Liggett of its Austin-Nichols division to Pernod Ricard. This did not deter Grand Metropolitan, which ultimately prevailed in the takeover of Liggett.

13 *Mobil v. Marathon Oil Co.*, supra, is the only case to consider directly the validity of "crown jewel" options; it held them to be invalid. The other cases cited in n. 9 above disagree with the rationale of *Mobil* and based on this analysis probably sustain such options, although they were not considered. In response to recommendation 42 of the Committee, the SEC has indicated that it is in favor of a revised application of the business judgment rule, where there is a disposition of assets during a tender offer through proposed legislation. SEC Response to the Committee's Report, supra, at 86,683.

14 White Knight would be a forced seller and would in effect, under *Kern County Land v. Occidental Petroleum*, 411 U.S. 582 (1973), not be deemed a seller, so that the purchase of stock could not be matched up against a sale to yield a short-swing profit that White Knight would have to disgorge.

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offering price is increased, at the highest price offered by White Knight), requiring management to tender its shares into White Knight's offer. The option from management for its shares was structured so that the shares had to be (or, from management's point of view, were permitted to be) tendered, thereby permitting management to realize (based on imperfect tenders) more than the blended price of $28 per share. White Knight's withdrawal date is July 11, 1984 and its expiration and proration date is midnight, July 18, 1984.

CASE C: ANALYSIS

First, White Knight's partial bid has aggravated its timing disadvantage. Its ability to purchase shares has been delayed five business days by the partial bid. White Knight has, however, concentrated all its extra economic power on its bid for control and has constructed a front-end bid 20% higher than Raider's bid. White Knight's bid is both economically and strategically superior to Raider's. An arbitrageur evaluating the bid takes into account the fact that if Raider competes, it will not tender its 5% of the shares, and that 10% of the other shares will probably not be tendered, thereby assuring a blended price of $29.41 (subject to a slight discount for the time it takes to effect the merger). The pricing has taken from Raider most of its alternatives in responding to White Knight's bid for all shares: (1) an increase in the number of shares to be purchased, while increasing the blended price, would not be as effective as increasing the price for fewer shares—in other words, adhering to the two-tier structure for majority control, and (2) termination of the offer by Raider with an attempt at open market purchases means that in all probability Raider will be purchasing shares at prices higher than $30, and the purchases in the open market would be excessive enough to subject Raider to the charge that the open-market purchases constitute a tender offer.

Interestingly, the grant of the option for 540,000 shares does not enhance the bid. It requires White Knight to bid for slightly fewer shares than Raider, making the White Knight bid marginally less attractive. At $28 per share (the blended per-share price), it does not provide a consolation prize. One question worth considering is whether the option could be sustained in court if it were granted at $20, the cash merger price.[15] It is clear that management would not accept such a price for the shares they own individually, and therefore White Knight would be paying the corporate treasury less than management (or the other stockholders) for their shares. The grant of the option at $20 would ensure that Raider, were it to change its bid, would have a strong incentive to adhere to the $20 second-step price.

The result of Raider's two-tier bid is to force White Knight to respond with a two-tier bid. It is the most effective response, except where White Knight can begin its bid within three or four days after Raider and can gain the advantage of an earlier time for payment by making an offer for all shares.[16]

What is remarkable is that, given a properly structured bid by Raider and with no significant bidding war, the lock-up options for stock do not advance White Knight's bid, and can in some instances harm it. As noted above, the "crown jewel" option could have a significant impact on the bidding.

Since Raider's two-tier bid can be neutralized by a counter two-tier bid that offers more cash per share, the next question is whether Raider gains any advantage by commencing a tender offer for all shares, assuming that Raider can obtain sufficient cash for such a bid.

CASE D: RAIDER'S TENDER OFFER

On June 1, 1984, Raider commences a cash tender offer for any and all of Target's 3,000,000 shares at $25 per share. On June 20, two days before Raider could have begun purchasing shares, White Knight makes its counter tender. Consider two alternative structures for the bid: (1) an "any and all" cash offer at $28 per share, with options to purchase stock from management and Target at $28 per share, or (2) a two-tier bid: a cash tender offer for 1,500,000 shares at $36 per share, to be followed by a cash merger transaction at $20 cash per share, with options to purchase stock from management and Target at $28 per share (or possibly at $28 per share from management and $20 per share from Target). The withdrawal, expiration, and proration dates for all offers are as in the other cases.

CASE D: ANALYSIS

White Knight's simplest and most direct response is alternative (1) of Case D above, the "any and all" offer at $28

15 Leading cases with respect to the validity of options are referred to in n. 10. None of them have considered the validity of options to purchase shares at under the market price; in all cases the prices have been at market. However, the basis for sustaining the options—the proper exercise of business judgment by the directors—should permit options to be granted at prices that will be effective.

16 CSX Corporation responded to the hostile bid of Colorado Interstate for Texas Gas Transmission Company within four days. In that case, Texas Gas, having had an intimation that there would be a hostile bid, had begun discussions with CSX, which was therefore in a position to respond promptly to the bid by Colorado Interstate. CSX first made a partial bid and then changed it to a bid for all shares, so that its bid actually expired before the bid of the Raider, Colorado Interstate.

per share. It is economically superior and wins. The question is, what does Raider do if it wants to increase its bid, or at least put itself in a winning position? If Raider increases its bid to $28 per share, it will win, since it finishes first and a matching bid commands all the shares. In the "any and all" pricing mode, that is Raider's only possible move. Using less funds than $28 per share for all shares, Raider could change to a two-tier bid at $34 for 1,620,000 shares and $20 per share in the second-step merger transaction. That action (at a blended price of $27) has put Raider in a winning position (based on the analysis in Case A above), unless White Knight counters with alternative (2), the two-tier bid at $36 per share for the tender and $20 per share for the second-step merger.

The analysis demonstrates that the "any and all" offer is not an effective bid for Raider, judged solely on strategy. Once White Knight has made its bid, Raider is forced to move to a two-tier bid. Changing the structure of its bid will lose Raider valuable time and could lose it a timing advantage. Accordingly, Raider's most advantageous bid is a two-tier bid, whether or not it has the cash for an "any or all" offer.

What effect can a self tender have on the bids of both Raider and White Knight? When the third-party tender offer proration rules were changed at the end of 1982, the self-tender rules were not changed; they require a minimum ten-business-day proration and withdrawal period and a twenty-business-day expiration period when made in response to Raider's tender offer.

CASE E: TARGET'S SELF-TENDER DEFENSE

Assume that Raider has commenced its two-tier bid on June 1: the bid is for $30 for 1,425,000 shares and $20 in equity securities for the remaining shares in the proposed merger transaction following the tender offer. Target, using its own cash and bank lines of credit, commences a self tender on June 11, 1984, for 1,500,000 shares at $34 per share. At that time Target is in discussions with, but has not lined up, a White Knight. Target retains the right to terminate the offer in the event of an offer by a third party—a White Knight. Target's management has reserved the right to tender into the self-tender offer. Target will obtain tenders of 70% of its shares without taking into account management's shares, and 85% with management's shares.

CASE E: ANALYSIS

The commencement of the self tender does not affect the proration, withdrawal, or expiration dates of Raider's offer, which remain midnight, June 28 (expiration and proration) and June 21 (withdrawal). Target's proration and withdrawal date is midnight, June 22, 1984, and expiration, June 29, 1984.

In constructing its offer, Target had two timing choices. It did not by law gain any time delays, such as an extension of Raider's offer. However, Raider usually is forced to extend its offer, since otherwise the self tender would expire later than Raider's offer and the higher self-tender price will keep shares away from Raider's offer. Assume that is what Raider will do.

Target has chosen to price its offer higher than Raider's to attract the shares, hold them in its depository, and force Raider to raise its price per share, as noted below. Raider has a number of possible responses: it can terminate its offer, putting itself in a position to buy blocks of stock after the offer; it can lower the tender price to $16 a share (thereby keeping the blended price of $25 per share for the balance of the shares remaining after the self-tender) if it believes that it will be able to attract tenders at that price (taking into account that the trading price of Target's stock was $15 per share before the offer) or raise its bid to $18 or more for the balance of the shares; or it can wait to see if a White Knight emerges. If a White Knight does not emerge, Raider will be in a position to acquire Target unless Raider could not support the additional debt incurred by Target as a result of the self tender, which is unlikely. Raider's best tactical choice is to wait and see what develops.

White Knight emerges on June 20, 1984. It has options to acquire management's 450,000 shares (15% of the outstanding shares) and an option from Target for 18% of the shares. Assuming that the stock lock-up options are effective, if Target completes its tender offer, White Knight would hold options for almost a majority of Target's shares. In effect, control passes on June 22, 1984, the date on which Target completes its self-tender. White Knight can acquire the remaining shares in a tender offer for any and all shares at $22 a share (a blended price of $28 per share), followed by a merger at the same price.

The self tender in this case does not affect the result, since in any event White Knight would have acquired control at $28 per share. What is important, however, is that control passes earlier than otherwise. Under other circumstances the self tenders affect third-party bids: for example, in the least disruptive situation, they can cause a delay in the third-party bidder's acquiring control. When the self tender is used as an offensive weapon, the proration rules, which are different from third-party rules, do not give all share-

holders equal access to the depository because of the shortened time periods.[17]

CASE F: TARGET'S "FAIR PRICE" DEFENSE

Assume that Target has a provision in its certificate of incorporation that provides "fair price" protection. The merger transaction following an opposed tender offer will require an affirmative vote of 80% of the outstanding shares, unless the price offered in that merger transaction at least equals the tender offer price. Target's "fair price" provision is designed to discourage two-tier bids. In Case A, Raider made a bid for control at $30 and offered $20 in the second-step merger. If management does not tender its 15%, Raider would probably not get the 80% vote of the outstanding shares (since 5% or more never votes), and therefore would not be able to acquire Target by merger.

CASE F: ANALYSIS

The issue is whether Raider should make a bid at $25 for all shares to avoid the application of the "fair price" provision, or proceed with the two-tier bid. Raider has every incentive to make the latter move (over a less effective bid for all shares at $25 per share) unless the "fair price" provision will prevent the second-step merger, since Raider is not prepared to pay $30 for the shares purchased in the merger. Raider must determine how realistic is management's veto of a merger transaction, that is, whether management will tender or holds its shares. Assuming that management would hold for a White Knight, if Raider is nevertheless successful, management would find itself with an illiquid investment. Raider, with control of the company, can cut the dividend and wear down former management over time. It is not worth risking a substantial portion of one's net worth to be a spoiler. If in the absence of a competing White Knight Raider has not raised the bid, management will try to negotiate an increase in price in return for its commitment to tender. If there has been a White Knight who has been outbid, it is unlikely that Raider would offer a further increase, and management would probably not be able to complain that the pricing was inadequate. There would be little choice except tendering.

This analysis turns on the fact that management has a large stake in the Target and too much to lose if its members do not tender. Is the result any different if management holds only a small portion of the outstanding shares and there are no other large blocks with a theoretical blocking position? Management may then be more inclined to try to block the second-step merger, but the public shares, facing illiquidity and the possible termination of dividends, would in all likelihood approve a second-step merger transaction at $20, which is still a premium over the trading price of the shares before Raider's initiation of its tender offer.

The above analysis indicates that the "fair price" provisions are no real impediment to Raider's bid. However, several important assumptions should be made explicit. First, Raider is well financed; that is, neither the banks financing Raider nor Raider itself are depending on Target's assets to support the purchase of the shares. Second, Raider is prepared to make it clear that if necessary it will wait before acquiring all of Target's shares. The ability to wait also defeats the impact of a staggered board of directors, which ordinarily would require Raider to wait for two annual meetings before obtaining control of the board of directors. In practice, the holder of a majority of the shares usually achieves control of the board well before then, since resistance after a majority of the shares has been acquired serves no purpose other than as a negotiating chip for the pricing of the second-step merger. Without a well-financed and determined bidder, the result could be different. The banks might not lend and Raider might be forced to make an offer for all shares, or no offer at all.[18]

CONCLUSION

While the SEC Advisory Committee on Tender Offers acknowledged the "coercive elements of partial and two-tier bids and the potential such bids provide for abusive tactics and practices," it refused to recommend their prohibition. Instead, it recommended a "regulatory disincentive" for such bids by providing a minimum offering period two weeks longer than the 30 calendar days it recommended for 100% offers or two-step offers in which the consideration for all shares was substantially equivalent. Further regulation designed as a disincentive would, however, have to contend with the cogent argument that Raider may not make a bid if there is little or no chance of winning. In response to the Committee's recommendation, the SEC refused to adopt such a disincentive and determined not to change the time periods for tender offers.

17 As indicated in n. 4 above, the SEC will propose legislation to prohibit defensive self tenders.

18 This analysis shows that if the voting requirement were increased from 80% to perhaps 95%, then perhaps the charter provisions would be more effective. The 80% test was used since it is a common supermajority voting requirement. The exercise of judgment is of course important, and higher voting requirements may not survive the scrutiny of the reviewing court. In recommendation 35 the Committee suggests that legislation should prohibit the use of charter and by-law provisions that erect high barriers to change of control. In response the SEC indicated that it shares the concerns of the Committee but was not now prepared to propose legislation. See SEC Response to the Committee Report, supra, at 86,681.

It is worthwhile to examine the process that a two-tier bid initiates. There are appropriate economic responses to two-tier bids, namely, a tender offer by a third-party bidder that can be for all shares at a blended price higher than the Raider's blended price, or a competing two-tier bid. In most cases, a tender offer, whether or not the initiating bid is a two-tier bid, encourages bids by others, resulting in an auction. Even though it may be an auction of competing two-tier bids, there are obvious benefits to the shareholders.

Two-tier bidding practices must also contend with state law. It is not yet clear that state law will integrate the two tiers and treat them as an offer at the blended price. *Singer* and its progeny have in fact considered the tender offers and the second-step mergers as different transactions.[19] The second step often appears inadequate when compared with the tender offer price meant to attract the shares that will grant control. If the *Singer* rationale prevails, two-tier bids could be discouraged by state corporate laws, which find the second-step price inadequate and require additional consideration before the second-step merger can be completed. It is not unreasonable, however, to expect that the courts will ultimately treat two-tier transactions as integrated transactions.

19 *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. Supr. 1977); *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). See Mirvis, *Two-Tier Pricing: Some Appraisal and "Entire Fairness" Valuation Issues*, 38 Bus. Lawyer 485 (February 1983), for an informative article that explores the limitations on how great a difference there can be between the tender offer bid and the second-step merger price in front-end-loaded bids.

North American Securities Administrators Association, Inc.

1984 Officers/Directors

CHAEL UNGER
rter
achusetts Securities Division
e Ashburton Place
ston, Massachusetts 02108

e President
WAYNE HOWELL
urer
rgia Securities Division
Martin Luther King, Jr. Drive
er Hill, West Tower
nta, Georgia 30334

retary
CHARD R. MALMGREN
missioner of Securities
. Box 1768
dison, Wisconsin 53701

surer
LAND COTÉ
e-Président
mmission des valeurs mobilières du Québec
. Box 246 Stock Exchange Tower
ntréal, Quebec H4Z 1G3, Canada

ssors

hard D. Latham
urities Commissioner
. Box 13167 Capitol Station
tin, Texas 78711

C. "Al" Marker
partment of Commerce
surances & Securities Bureau
6 Mercantile Way
e Office Box 30222
sing, Michigan 48909

ston J. Mihaly
sistant Attorney General
e Charge
reau of Investor
otection & Securities
partment of Law
World Trade Center
w York, New York 10047

ur W. "Buster" Sewell
ate Secretary of State
partment of State
urities Division
te Capitol Capitol Complex
son City, Nevada 89710

G. "Rick" Tucker
ef Deputy
curities Commissioner
curities Department
ckell Building
. Box 4009
lena, Montana 59604

———

curities Secretary
ar Borden
5 S.W. Wanamaker Dr., Suite 5
peka, Kansas 66614
13) 273-3600

June 19, 1984

Representative Timothy E. Wirth
Chairman
Subcommittee on Telecommunications,
Consumer Protection and Finance
Washington, D.C. 20515

Dear Representative Wirth:

Re: Mark-Up of Proposed Legislation
Curbing Tender Offer Abuses

The North American Securities Administrators Association, Inc. ("NASAA"), through its President and members of its Tender Offer Committee wish to take this opportunity to strongly urge that the proposed legislation to limit tender offer abuses that is scheduled for mark-up within the next several days by the Subcommittee include all the items referred to below, several of which were previously introduced in bill form by the Subcommittee Chairman.

The Subcommittee Chairman, Subcommittee members, and their respective staffs are to be commended for their concern in this area and their diligence in formulating proposals in a complicated and technical area of law to specifically identify and redress many specific areas of shareholder abuse that have developed over the years in the tender offer process as a result of acts and practices by both bidders and target companies. NASAA, in a previous comment letter to this Subcommittee and in testimony before it during hearings this spring on this subject, has gone on record publicly in support of several specific and sorely-needed amendments to the federal tender offer scheme (which scheme has not been substantially modified since enactment of the Williams Act in 1968) that go beyond the recommendations of the Securities and Exchange Commission's Advisory Committee on Tender Offers, and the specific legislative proposals of the Securities and Exchange Commission based on certain

of those recommendations. This Association has on several occasions and in several forums indicated that state securities administrators do not have as their purpose widening their authority or jurisdiction in this area, but rather their concern is remedying the current problems and abuses in the tender offer area in the interest of public investors who have been in the past, and continue to be, victimized by them. It is also the view of this Association that acting forcefully through legislation on the federal level containing all of the items listed below to confront the most serious of the tender offer abuses is not only in the interest of public investors, but it also is in the best interest both of corporate America which is currently engaged in a mass scramble for survival in the acquisition mania, and of the securities marketplace whose integrity has been subverted.

In that regard, during the Subcommittee's mark-up process, whether separate bills will be prepared on various subjects or one omnibus bill created, NASAA feels that legislation incorporating all of the following subjects that deal with both bidder and target company practices is necessary in the public interest:

(1) The entirety of the recommendations of the Securities and Exchange Commission currently contained in HR 5693 should be included--provided that the three amendments in Attachment A to this letter are included. Although the SEC's bill, incorporating certain recommendations of its Advisory Panel, does not take the decisive action set forth in the following numbered paragraphs to effectively deal with some of the worst areas of shareholder abuse that have developed, HR 5693 nonetheless would effectively remedy several substantive problem areas that virtually everyone has acknowledged warrant remedying (everyone, that is, except for the users of those techniques who have profited by them over the years at the expense of shareholders and the integrity of the securities marketplace). Consequently, the SEC proposals--to close the "10-day" window for Schedule 13D filings, to prohibit "golden parachutes" once a tender offer was initiated, to curtail "greenmail" repurchases by a target company and to curtail certain defensive tactics of target companies including self-tenders, "lock-ups" and "poison pills"--should be included as modified in the three respects set forth in Attachment A to this letter.

(2) The proposal in HR 5694, (based on a proposal submitted by Attorney Martin Lipton during the

Subcommittee's hearings this spring and endorsed by NASAA in our February 29, 1984 comment letter to this Subcommittee, and paralleling a similar recommendation of the SEC's Advisory Panel at a 20% stock ownership level) that would prohibit two-tier, front-end loaded tender offers which coerce shareholders into accepting a tender offer, must be included as a key component in any effective legislative package to remedy tender offer abuses.

This proposal (which requires that once a bidder acquires 10% of a company's shares, the bidder would have to make a tender offer at the same price for the remainder of the shares in order to acquire any beyond 10%) is doubly critical because it would also act to remedy a serious abusive practice not dealt with effectively by any of the other proposals to date--namely, the so-called "creeping" tender offer situation. This abusive practice whereby bidders embark on a secretive or disguised change of control buying program, does not allow the public equal access to participate in the change of control, makes a mockery of federal tender offer disclosure filing requirements, and exploits the securities trading markets. This abusive practice has been allowed to exist in the federal regulatory scheme for years, and attempts to remedy the problem through the courts by application of informal Securities and Exchange Commission criteria for determining what constitutes a tender offer have been woefully inadequate. There have been and continue to be innumerable instances of purchasers who have been able to take advantage of this deficiency in the federal law to consolidate large (sometimes controlling) blocks of a corporation's shares to the detriment of its public shareholders.

Another related benefit of the Must-Offer-For-All-Shares-If-Exceed-10% proposal would be to further discourage "greenmail" (beyond the prohibitions in HR 5693) by precluding bidders from assembling more than 10% of a target's shares before seeking to coerce the target company into repurchase of those shares at a premium. Again, to emphasize, inclusion of this proposal is essential to enactment of a truly effective legislative package to remedy tender offer abuses.

(3) The proposal embodied in HR 5695 that would require the management of a target company not only to satisfy the business judgment rule, but also to show that a defensive anti-take-over tactic was prudent for the issuer and fair to shareholders should also be included in the legislative package. The proposal would provide the shareholders of a target company, as well as the Securities and Exchange Commission, with an effective and timely mechanism to call target company management "on the carpet" to establish that a target company's actions in instituting certain defensive maneuvers against a tender offer were both prudent for the company and fair to the company's shareholders. The proposal provides that such will be done in a forum--a court proceeding-where the issues can be fully presented and discussed and where effective action can be taken by injunctive or other appropriate remedy before the shareholders of the target are left with a crippled company that may no longer be financially or economically viable--a result disastrous to shareholders, the company's employees, the local community the company serves, and the economy. The proposal in HR 5695 appears fair in its coverage since in connection with any court proceeding regarding the defensive tactics, management would not be liable if it could show that its actions met not only the business judgment rule but also the test of being prudent to the company and fair to shareholders.

Responsible corporate managers who undertake defensive actions in the face of a tender offer should not fear this legislation where their motivations are truly focused on the best interests of the company and its shareholders. It is suggested, however, that in the interest of equal treatment, the last sentence of section (h)(1) of the proposal (which gives a court the <u>discretion</u> to award attorney's fees to a shareholder) be amended to permit a court <u>equal discretion</u> to award attorney's fees to the company who meets its burden of proof in the court proceeding. The ability of a target company management to recover legal fees in the discretion of the court is warranted to protect a target company and its management from nuisance or strike suits by shareholders who might be market professionals or arbitrageurs who are interested only in the short-term profit in a successful

tender offer and have little regard for the viability of the company or the best interests of its other shareholders. Further, because the award of attorney's fees to a target company's management is discretionary, not mandatory, shareholders should not be deterred by this provision where their motivations are truly in best interests of the company and its shareholders.

(4) NASAA strongly recommends that any final package of legislation in this area include an amendment to the federal tender offer regulatory scheme to require that tender offers remain open for a minimum 60 calendar day period, as was recommended by several witnesses (including economists and investment bankers) presenting testimony at the Subcommittee's hearings this spring. The current 20 business day requirement (which translates into 26 to 28 calendar days) is inadequate to allow dissemination and disclosure of information and opportunity for action by non-professional investors, especially where multiple competing bids are involved. Requiring tender offers to remain open for at least 60 calendar days would balance the element of surprise benefitting a bidder with the corresponding ability of a target company to undertake defensive actions that are prudent to the company and fair to shareholders and/or attract competing bids. In competing bid situations, target company shareholders are benefited by the higher prices that result from the auction process that develops.

There is no public policy reason that bidders should be considered to have an inalienable right to acquire during a 20 business day period, control of a corporation whose business, products, management, shareholders and employees have developed over decades. Indeed, the SEC's Advisory Panel concluded there is insufficient basis for concluding that takeovers are either per se beneficial or detrimental to the economy, securities markets, issuers or their shareholders.

The time constraints within which a tender offer can be made or consummated are exclusively a legislative decision which should be made by Congress based on a full understanding of the results and consequences of the choosing of a particular minimum tender offer duration date. In

a different regulatory context, Congress has already established under the Hart-Scott-Rodino Act that determinations in anti-trust situations must be conducted over a substantial period of time in order for the interests of the public to be fully considered. For the above reasons, changing the current 20 business day requirement under the federal tender offer regulatory scheme to a 60 calendar day period is necessary in the public interest.

(5) A final item relates to a matter that is not in any legislative proposal before the Subcommittee but rather is a rule-making proposal by the SEC that would put a tender offer involving securities (being offered for the target's shares) on the same level as a cash offer for the target's shares. It is the view of NASAA (as set forth in our prior comment letters and in testimony before this Subcommittee) that if such SEC proposal is allowed to go into effect, it will result in a new generation of shareholder and marketplace abuses--particularly in hostile tender offers where management and shareholders would be forced to react quickly to offers involving "funny money" securities of dubious value and uncertain marketability.

It would be a tragic and disastrous result to have a situation develop where, after effective Congressional legislation was enacted containing the above-recited items resolving virtually all the abuses in the current cash tender offer scenario, the SEC were allowed through its rule-making procedures to undermine this legislative process of remedying tender offer abuses. The procedures and requirements currently established under the federal securities laws before an offeror can publicly offer or sell its securities have served the public interest well and should not be modified, particularly since the SEC's rule-making proposal appears to be a gratuitous regulatory benefit to bidders where no public interest has been shown to exist in support of it. Consequently, the legislative package developed by the Subcommittee should expressly preclude tender offers involving exchanges of securities from use of the procedures established for tender offers using cash only.

The proposed legislation to be considered for mark-up by the Subcommittee represents a critical opportunity that must not be missed to make needed changes that are in the public interest to the federal tender offer regulatory scheme. Further, the key changes and items listed above that are necessary to achieve a comprehensive and effective legislative package must not be eliminated from the package by special interest proposals favoring either bidders or target company management.

Respectfully,

Michael Unger
NASAA President

Rodger A. Marting
Chairman, Tender Offer Committee

Randall E. Schumann
Vice Chairman, Tender Offer Committee

RES:klr

Attachment A

Specific Amendments Required to HR 5693

(1) Section 3 of HR 5693 should specifically establish 2 business days as the time period (after the filing of a Schedule 13D) that a purchaser is barred from additional purchases of a target's stock. It takes the marketplace and the media at least 2 business days to "digest" the information in a Schedule 13D, thus there is no reason to provide discretionary authority to the SEC to, by rule, designate what could be a 1 day holding period or even a no-day holding period. There is no reason to grant the SEC rule-making authority in this regard inasmuch as the only change from a 2-day holding period requirement would be toward a shorter period that adversely impacts the ability of the marketplace and public shareholders to receive and digest material information regarding the target company.

(2) A second and similar area of concern with HR 5693 is Section 2 which would give the SEC rule-making authority to prescribe the time period within which a person must file the Schedule 13D. It is proper and appropriate for Congress in this legislation to specify a 10 day regulatory filing requirement. The problem with giving the SEC total discretion to establish any maximum time period within which to file the Schedule 13D may result in a unduly long period being established by rule, within which the purchaser may conduct take-over related activities that may create confusion in the marketplace due to the lack of full public dissemination of the information that would be contained in a Schedule 13D filing.

(3) The third of area of concern in HR 5693 relates to Section 5 of the bill which repeals para. (2) of subsection 14 of the 1934 Act. Paragraph (2) deems 2 or more persons acting as a partnership or group to be a "person" for purposes of Section 14. NASAA is unaware of any need for the repeal of this provision, nor has there been any showing by the SEC as to the public interest served by the repeal. Our concern is that the deletion would remove coverage of the securities laws and those sections prescribing unlawful conduct in connection with proxy contests and the filing of Schedule 13D's merely by having individuals and entities otherwise subject to those laws form partnerships. If in fact it is the case that the effect of the proposed deletion/repeal of 14(d)(2) would result in individuals or corporate entities avoiding the proscriptions of the securities laws merely by forming a partnership, Congress should not permit this repeal because it is not in the best interest of the investing public or the securities marketplace.

North American Securities Administrators Association, Inc.

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1983-84 Officers Directors

President
MICHAEL UNGER
Director
Massachusetts Securities Division
One Ashburton Place
Boston, Massachusetts 02108

Vice President
H. WAYNE HOWELL
Director
Georgia Securities Division
2 Martin Luther King, Jr. Drive
Suite 802, West Tower
Atlanta, Georgia 30334

Secretary
RICHARD R. MALMGREN
Commissioner of Securities
P.O. Box 1768
Madison, Wisconsin 53701

Treasurer
ROLAND COTE
Vice President
Commission des valeurs mobilières du Québec
P.O. Box "De" Stock Exchange Tower
Montreal, Quebec, H4Z 1G3 Canada

Directors

Richard D. Latham
Securities Commissioner
P.O. Box 13167, Capitol Station
Austin, Texas 78711

E. C. "Al" Markes
Department of Commerce
Corporations & Securities Bureau
6546 Mercantile Way
Post Office Box 30222
Lansing, Michigan 48909

Chester J. Mihals
Assistant Attorney General
in Charge
Bureau of Investor
Protection & Securities
Department of Law
2 World Trade Center
New York, New York 10047

Abner W. "Buster" Sewell
Deputy Secretary of State
Department of State
Securities Division
State Capitol, Capitol Complex
Carson City, Nevada 89710

R. C. "Rick" Tucker
Chief Deputy
Securities Commissioner
Securities Department
Mitchell Building
P.O. Box 4009
Helena, Montana 59604

Executive Secretary
Bruce Bendis
2950 S.W. Wanamaker Dr., Suite 5
Topeka, Kansas 66614
(913) 273-2600

July 26, 1984

Committee Member
U.S. House of Representatives
Committee on Energy and Commerce
Washington, D.C. 20515

Re: Inclusion of H.R. 5972 Concepts in Committee Legislation Curbing Tender Offer Abuses

Dear Committee Member:

The North American Securities Administrators Association, Inc. ("NASAA"), through its President and members of its Tender Offer Committee strongly urge that the proposed legislation to limit tender offer abuses include the two concepts embodied in H.R. 5972 relating to: (1) extending the minimum tender offer period to 60 days; and (2) providing target company shareholders and the Securities and Exchange Commission a narrow remedy to enjoin actions taken by target company management opposing a hostile tender offer.

The Subcommittee Chairman, Subcommittee members, and staff are to be commended for their diligence in formulating the proposals in H.R. 5972 and H.R. 5694 that would specifically identify and redress the most serious of the areas of shareholder abuse. NASAA, in previous comment letters and testimony, has gone on record supporting several specific amendments to the federal tender offer scheme that go beyond the recommendations of the Securities and Exchange Commission's Advisory Committee on Tender Offers, and the legislative proposals of the SEC that are currently embodied in H.R. 5693. This Association has previously stated that state securities administrators do not wish to widen their authority or their jurisdiction in this area. Rather, their concern is remedying the current problems and abuses in the tender offer area in the interest of public investors. It is also the view of NASAA that Federal legislation which remedies the most serious of the tender offer abuses is in the best interest of public investors, America's corporations, and the integrity of the securities marketplace.

The SEC's proposals embodied in H.R. 5693 are at best a "Band-Aid" approach, that fails to address the worst of the tender offer abuses. These abuses can be corrected by including the items in the numbered paragraphs below that deal with bidder and target company practices. Consequently, with respect to the SEC's recommendations embodied in H.R. 5693, NASAA's support for that measure is qualified since the provisions prohibiting certain defensive tactics in response to hostile tender offers would not be necessary, if the Committee's proposed legislation included the H.R. 5972 concept discussed in paragraph 2 below. That concept is a more effective remedy than a bill

prohibiting a "laundry list" of specific anti-take-over practices in vogue today, which legislation could be rendered obsolete by a new tactic developed tomorrow.

(1) NASAA strongly urges that the Committee's recommended bill include the proposal in H.R. 5972 that the federal tender offer regulatory scheme be amended to require that tender offers remain open for a minimum 60 day period. This proposal was recommended by several witnesses including economists, academics, prominent investment bankers and this Association in testimony at the Subcommittee's hearings this spring. The current 20 business day offering period provision under federal law (which translates into 26 to 28 calendar days) is inadequate to allow dissemination and disclosure of information and opportunity for action by non-professional investors, especially where multiple competing bids are involved. Requiring tender offers to remain open for at least 60 calendar days would balance the element of surprise favoring a bidder, with the ability of a target company to take defensive actions that are prudent to the company and fair to shareholders. Additional time also permits greater opportunity for competing bids. In competing bid situations, target company shareholders benefit from the higher prices which result from the auction process.

There is no sound public policy reason to give bidders an opportunity to acquire in 20 business days the control of a corporation whose business may have developed over decades. Indeed, the SEC's Advisory Panel specifically stated there is insufficient basis for concluding that takeovers are per se beneficial to the economy, securities markets, issuers or their shareholders. Further, prescribing a 60-day minimum offering period cannot be considered radical legislation. Such an amendment would act merely to provide a reasonable extension of the tender offer period. The benefits would be immediate and significant: (a) eliminating many of the abusive defensive tactics by management that are simply efforts to "buy time"; and (b) preventing bidders from pressuring corporate managers and shareholders into making hasty and confused decisions.

The time constraints within which a tender offer can be made or consummated are exclusively a legislative decision which should be made by Congress. In a different regulatory context, Congress has already established under the Hart-Scott-Rodino Act that determinations in anti-trust situations must be conducted over a substantial period of time in order for the interests of the public to be fully considered. For the above reasons, changing the current 20 business day federal regulatory scheme to a 60 calendar day period is necessary in the public interest.

(2) The proposal embodied in H.R. 5972 that would require the management of a target company not only to satisfy the business judgement rule, but also to justify the business anti-take-over tactic was prudent for the issuer and fair to shareholders should also be included in the legislative package. The proposal would provide the shareholders of a target company and the SEC with an effective and timely

mechanism to call target company management "on the carpet" to establish that its actions in instituting defensive maneuvers aganist a tender offer were prudent for the company and fair to its shareholders. The proposal provides that legal action can be initiated which seeks injunctive or other appropriate relief, thereby permitting a thorough presentation of the issues concerning the take-over before irreparable harm to the target, its shareholders, employees and the public occurs. The proposal in H.R. 5972 is fair since liability would not attach to target company management using defensive tactics, if they can show that its actions met not only the business judgement rule but also the test of being prudent to the company and fair to shareholders.

Responsible corporate managers who undertake defensive actions in the face of a tender offer should not fear this legislation where their motivations are truly focused on the best interests of the company and its shareholders.

(3) As a final item, NASAA strongly urges that the Committee's recommended legislation include the proposal previously introduced in H.R. 5694, which by itself would result in Congress effectively remedying the three worst areas of shareholder abuse caused by bidder practices--namely, coercive "two-tier" offers, "greenmail" repurchases of bidder's shares by target companies, and so-called "creeping" tender offers.

This proposal would require that once a bidder acquires 10% of a company's shares, a bidder would have to make a tender offer at the same price for the remainder of the shares in order to acquire any shares beyond 10%. The proposal (which parallels a similar recommendation by the SEC's Tender Offer Advisory Panel at a 20% stock ownership level) would effectively prohibit two-tier, front-end loaded tender offers which coerce shareholders into accepting a tender offer. The coercive elements of two-tier bids and the potential such bids provide for abuse were acknowledged in the SEC's Advisory Panel Report. This proposal would also remedy a serious abuse known as a "creeping" tender offer. This abusive practice, whereby bidders embark on a secretive or disguised change of control buying program, does not allow the public equal access to participate in the change of control, makes a mockery of federal tender offer disclosure filing requirements and exploits the securities trading markets. Creeping tender offers have been allowed to exist under the federal regulatory scheme for years. Attempts to remedy the problem through the courts by application of informal SEC criteria for determining what constitutes a tender offer have been woefully inadequate. There have been and continue to be innumerable instances of purchasers able to take advantage of this deficiency in the federal law to consolidate large (sometimes controlling) blocks of a corporation's shares to the detriment of its public shareholders.

The third benefit of the "Can't-Exceed-10%-Unless-Offer-For-All-Shares" proposal would be to eliminate most "greenmail" repurchases by a target company of its shares because bidders would be precluded from assembling more than 10% of a target's shares.

The proposed legislation to be recommended by the full Committee represents a critical opportunity to make needed changes in the federal regulatory scheme by: (1) extending the minimum tender offer period to 60 days: (2) providing shareholders an effective remedy to check the excesses of target company defensive tactics; and (3) enacting a "Can't-Exceed-10%-Unless-Offer-For-All-Shares" requirement. It is NASAA's view that the key elements discussed above are necessary to achieve a comprehensive and effective legislative package and should not be blocked by special interest representatives favoring either bidders or target company management.

Respectfully submitted,

Michael Unger
NASAA President

Rodger A. Marting
Chairman, Tender Offer Committee

Randall E. Schumann
Vice Chairman, Tender Offer Committee

North American Securities Administrators Association, Inc.

1983-84 Officers/Directors

President
MICHAEL ENGER
Director
Massachusetts Securities Division
One Ashburton Place
Boston, Massachusetts 02108

Vice President
H. WAYNE HOWELL
Director
Georgia Securities Division
2 Martin Luther King, Jr. Drive
Suite 802, West Tower
Atlanta, Georgia 30334

Secretary
RICHARD R. MALMGREN
Commissioner of Securities
P.O. Box 1768
Madison, Wisconsin 53701

Treasurer
ROLAND COTE
Vice-President
Commission des valeurs mobilieres du Quebec
P.O. Box 246, Stock Exchange Tower
Montreal, Quebec H4Z 1G3 Canada

Directors

Richard D. Latham
Securities Commissioner
P.O. Box 13167, Capitol Station
Austin, Texas 78711

E. C. "Al" Marker
Department of Commerce
Corporations & Securities Bureau
6546 Mercantile Way
Post Office Box 30225
Lansing, Michigan 48909

Ornette J. Mihals
Assistant Attorney General
in Charge
Bureau of Investor
Protection & Securities
Department of Law
2 World Trade Center
New York, New York 10047

Abner E. "Buster" Sewell
Deputy Secretary of State
Department of State
Securities Division
State Capitol, Capitol Complex
Carson City, Nevada 89710

R. C. "Rick" Tucker
Chief Deputy
Securities Commissioner
Securities Department
Mitchell Building
P.O. Box 4009
Helena, Montana 59604

Executive Secretary
Bruce Bunch
2950 S.W. Wanamaker Dr., Suite 5
Topeka, Kansas 66614
(913) 273-2600

September 28, 1984

Office of the Secretary
U.S. Securities and Exchange
Commission
450 Fifth Street, N.W.
Washington, DC 20549

Dear Sir:

Re: SEC Release No. 34-21079/Response to Commission Request for Comments Regarding Certain Tender Offer Bidding and Acquisition Practices

The North American Securities Administrators Association, Inc. ("NASAA"), and its Tender Offer Committee is taking the opportunity extended by the Commission in Release No. 34-21079 to provide comments regarding certain tender offer bidding and acquisition practices. In particular, comments were requested by the Commission regarding: (1) so-called "two tier" offers and "creeping" tender offers; and (2) certain recommendations of the Commission's 1983 Advisory Committee on Tender Offers ("Advisory Panel"), including that Panel's recommendations of a 20% "threshold" at which point subsequent share acquisitions would have to be by tender offer, and that partial tender offers be held open for two weeks longer than "all or nothing" offers.

The views of NASAA on these important issues are well known to the Commission in that NASAA, in a position paper and testimony during the July 1983 public forum of the Advisory Panel attended by members of the Commission: (1) strongly recommended prohibiting two-tier offers as per se manipulative; and (2) strongly urged that the Advisory Panel's 20% threshold recommendation be adopted at a lesser percentage (namely, 10%) which would be substantially more effective than a 20% level in eliminating the abusive tender offer

bidding and acquisition practices of "creeping" tender offers and "green-mail."

NASAA has also specifically gone on record with respect to its position on these issues in hearing testimony to Congressional Committees on the House side earlier this year, and in comment letters to two House Committees relating to House-sponsored legislation to curb tender offer abuses (including the Commission's own legislative proposal, contained in H.R. 5693 that was up for consideration by those Committees). NASAA's analysis and rationale in support of its views on these issues has been particularized in the two comment letters referred to above sent to the House Committees, and rather than reiterate the same points in this letter, please refer to the enclosed photocopies of NASAA's June 19 and July 26, 1984 letters.

Supplemental Comments on Two-Tier Offers

By way of supplementary comment, the coercive nature of the two-tier offer has been well documented and discussed at length by commentators over the last two years. Its coercive nature is evident from its basic structure--namely, that it is almost foolhardy for a shareholder not to tender in the offer (particularly if it is the only tender offer on the table) and thus lose out on the first tier premium if the offer is successful, thereby leaving a non-tendering shareholder with shares entitled only to the lower second tier price (or a reduced market price reflecting such second tier price). The result of this bidding technique is to force stockholders into rush-to-judgement decisions with respect to offers that are often exceedingly complex--especially when the second tier of the offer is non-cash and difficult to evaluate or when competing bids are involved.

It is significant to note that even the Commission's Advisory Panel recognized the coercive nature of two-tier offers and recommended a regulatory "disincentive" to such offers that would make the minimum offering period for tender offers for less and all shares approximately two weeks longer than that for an offer for all shares. That such a disincentive would significantly affect the prospects for the success of a two-tier offer is acknowledged by the comments in the attached law journal article The Review of Securities Regulation, April 18, 1984 edition, that was written by an

attorney in one of the leading New York law firms specializing in tender offers. The article points out on page 919 thereof and in footnote 8 that it is the combination of the timing advantage a bidder has in deciding when to commence an offer plus the short twenty-day tender offer period currently allowed under federal law that allows the two-tier offer to be so "successful" in "coercing" tenders of target company shares in two-tier offers. The article also underscores the coercive nature of two-tier offers by showing that such offers are highly successful under nearly every fact scenario. It is hard to escape the conclusion that this bidding technique is coercive when it is shown to be successful in nearly every fact situation, even where a target company has standard anti-takeover defenses in place and a "White Knight" at its side.

The two-tier bidding technique, whose success relies on its coercive nature that is based on surprise and the ability to complete the tender offer transaction within the short twenty-day period currently allowed under the federal tender offer regulations, is totally at odds with the free market concept of "willing buyer-willing seller"--the premise and foundation of the national securities markets which the Securities and Exchange Commission has a mandate to foster and protect.

Consequently, in the interests of investor protection and protecting the integrity of the securities marketplace, two-tier offers should be deemed per se' manipulative under the federal securities laws. As such, they should either be prohibited directly or the "20% threshold" proposal should be adopted that would effectively curtail two-tier offers. At the very least, the Commission should take immediate action to adopt by rule the "disincentive" recommendation of the Advisory Panel which precludes use by two-tier bidders of the timing advantage allowed under current federal tender offer law.

As the best alternative, however, NASAA would recommend adoption by the Commission of a very simple amendment changing from twenty days to sixty days the existing federal rules establishing the minimum period a tender offer must remain open--a position long advocated strongly by NASAA. Such an admendment would not only prevent bidders from pressuring corporate managers and stockholders into making hasty decisions as a result of coercive two-tier offers, but would eliminate at the same time many of the abusive anti-takeover

practices by target company management that are simply efforts to "buy time".

"20% Threshold, "10% Threshold" and "Control as a Corporate Asset"

With regard to eradicating two-tier offers, the "Twenty percent threshold" concept would accomplish that result. An even more effective step, one that NASAA has advocated in support of legislation on the House side in H.R. 5694 and which Senate Securities Subcommittee Chairman D'Amato introduced in S. 2783, would be a 10% threshold level which in one single and effective action would eliminate the three worst areas of shareholder abuse caused by bidder practices--namely, not only coercive two-tier offers but also so-called "greenmail" repurchases of bidder shares by target companies, and so-called "creeping" tender offers. A ten percent threshold proposal would effectively discourage "greenmail" and "creeping" tender offers because bidders would be precluded from assembling more than 10% of a target's shares to use to either coerce management into repurchasing the shares or as a springboard to a formal tender offer.

It is recognized that both the 20% and the 10% threshold concepts will result in precluding all partial tender offers as well as two-tier offers (which latter happen to be the abusive manifestations of partial offers). However, viewing "control" of a corporation as an asset of the corporation that each share of stock represents an equivalent portion of, no bidding practice should be permitted that fails to accord all shareholders of the corporation, particularly its small public shareholders, their right to receive their full participation when "control" of the corporation is acquired. This same premise underlies the so-called "control share acquisition" concept in recent amendments by several states (Ohio, Wisconsin, and Minnesota) to their respective Business Corporation Laws. Under those corporation law amendments, control of a corporation is considered one of the corporation's assets, and just as a sale or transfer of all or substantially all of the corporation's assets is subject to approval by majority vote (51% or 2/3) of shareholders under the state corporation law, the transfer of control of that corporation should similarly be the subject of shareholder self-determination by vote of those shareholders to approve the "sale"/acquisition of control.

Following the report of the Advisory Panel in 1983, NASAA was distressed that the Commission's responses to the serious tender offer abuses prevalent in the marketplace by both bidders and target company management was the legislative proposal that, as embodied in H.R. 5693, remedied some concerns but failed to address the most serious of the abusive practices--particularly two-tier offers.

With the advent of the Commission now seeking comment on the two-tier offer issue and the other concepts discussed above which if adopted could effectively eliminate creeping tender offers and greenmail repurchases, and with the current composition of the Commission which has an opportunity to view these issues afresh, NASAA is hopeful that the Commission will do the following: (1) conclude that coercive two-tier tender offers that stampede public investors into hasty and often less-than-fully-informed decisions has no place in a national securities marketplace which the Commission is under mandate to keep orderly; (2) take appropriate action to either prohibit two-tier offers outright or establish minimum timing provisions in the federal tender offer scheme (by extending the current twenty-day offering period to sixty days) to allow true "free market" forces to develop for the acquisition of control of the target company; and will (3) support the 20% threshold concept at a 10% level in legislation such as H.R. 5694 and S. 2783 that would eliminate the additional abusive practices by bidders of creeping tender offers and greenmail repurchases.

NASAA appreciates this opportunity to present its views, and if you have questions or need additional information regarding any of the matters discussed above, please call Committee Chairman Orestes Mihaly of New York at (212)488-7563 or Committee Vice Chairman Randall Schumann of Wisconsin at (608)266-2139.

Respectfully submitted,

H. Wayne Howell
NASAA President

Orestes J. Mihaly
NASAA Tender Offer Committee
Chairman

Randall E. Schumann
NASAA Tender Offer Committee Vice Chairman

RES:klr
Enclosures

UNITED STATES SENATE

HEARINGS BEFORE THE SENATE
COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

OCTOBER 2, 1984

Statement of Michael R. Klein

I am an attorney, active over the past 15 years as a practitioner, teacher and commentator concerning various aspects of federal securities regulation. I am a partner in the Washington, D.C. law firm of Wilmer, Cutler & Pickering, and the Chairman of an ABA Subcommittee on Civil Litigation under the federal securities laws. However, this testimony is not submitted on behalf of my firm, any of its past or present clients or any ABA unit. It is a statement of my own views of what I believe is in the public interest. I have not cleared nor even discussed this statement with my firm, any of its clients or any ABA unit.

TAKEOVER LAW REQUIRES GENERAL SUBSTANTIVE FEDERAL REFORM

I have come to the view that the time has come for Congress to consider anew whether existing federal legislation in the area of contests for corporate control is adequate. My reasons include the following: The extent and frequency of abuses committed by incumbent corporate officers and directors who use their office to fight off uninvited tender offers or proxy contests or to buy out their own shareholders has become a public scandal. The frequency and substantiality of these abuses rise to a level that the subject should be of a federal interest. Legislation is required because the current legal system has done little or nothing to retard or prohibit these abuses. In case after well-publicized case, the law has failed to cope with corporate incumbents who abuse their power and their shareholders in order to defend or solidify their control of the corporation. This pattern has invoked widespread dismay and despair on the part of shareholders and observers alike. It has been a long time since the gap between the public's impression of right and wrong and the legal system's incapacity or unwillingness to address the circumstance has been so dramatic.

From a legal standpoint the nature of the breakdown in our existing legal system is fairly simple to pinpoint. At present, the federal securities laws confine themselves almost exclusively with disclosure and procedure fairness. In part this is because the Supreme Court's interpretation of the relevant sections of the federal securities laws has all but eviscerated any prospect that the current statutes offer a federal remedy. In any event, as a matter of legal history, the issue of substantive fairness has been thought of primarily as one of state law. There does exist, in traditional state corporate law, a legal principle which might be used to grapple with these abuses. That state legal principle, of course, is the "business judgment rule." Unfortunately, with one or two recent exceptions, that principle has itself been routinely eviscerated in this arena of takeovers and leveraged buyouts by a pattern of perverse state court constructions.

It may prove worthwhile to review, for a moment, that principle and those developments. One cannot overstate the centrality of the business judgment rule to the American system of corporate law. Under the laws of every state, the business judgment rule presumes that great judicial deference will be given to a corporate judgment, made in the ordinary course of business by the corporation's officers or directors.

Viewed in the abstract, the business judgment rule seems a sensible response to a variety of considerations. The case in favor of having a business judgment rule is a strong one. It would be too much were our already litigious national instincts permitted to drag into the courts routine or even important business decisions simply because, as is nearly always the case, someone felt aggrieved by the decision. Absent such a rule, an already overtaxed judiciary could too frequently be faced with litigation involving little more than the capacity of reasonable men with competing interests, and effective counsel, to persuasively differ over nearly any decision involving money. Moreover, the courts likely feel comforted that while they are closing the doors to such suits, in most instances disgruntled corporate citizens have available other nonjudicial avenues through which to act out their distress. They can, for example, sell their shares or use the corporation's proxy machinery. Accordingly, the business judgment rule -- in the abstract at least -- seems a perfectly prudent solution to a general circumstance.

The problem is that, as judicially employed in the specific context of contests for corporate control, this fine sounding judicial-political compromise has proven to be an abject failure. The pace and intensity of takeover battles and

leverage buyouts renders the usual range of shareholder options meaningless. In these cases, shareholders are so much flotsam carried away by the tidal wave of self-interests. And there is no other remedy, no other forum, no other avenue for relief than the courts. Unfortunately, courts faced with litigation involving takeover and proxy contests have not acted responsibly. Instead of employing the main business judgment rule as they have, they should employ the corollary of the rule. The rule's corollary, of course, is that where there is persuasive evidence that self-interest has motivated a corporate decision, the judiciary will, however reluctantly, either independently assess the reasonableness of the decision or require the corporation to overcome a presumption of the decision's unfairness.

Permit me to explain why the corollary of the business judgment should apply to these cases. Tender offers and proxy contests are challenges to corporate control. Everyone, except the courts it seems, understands that and the implications of such challenges for human behavior. The natural human reaction expectable in the face of any challenge to one's possession of control over assets, power or prestige is to fight back, angrily, wildly, even if such emotionalism is otherwise out of character. And the natural instinct of friends and close associates of a person so threatened is to support them. And that, of course, is precisely what management and their boards of directors too often have done when they are confronted with an uninvited challenge to their corporate control. In an ever ascending frenzy of perverse inventiveness, challenged incumbents aided and abetted, if not encouraged and directed, by their highly compensated investment bankers and special counsel, have shown themselves inclined to pursue corporate actions that would never have been otherwise considered, and which are almost always contrary to the interests of their shareholders. Profitable subsidiaries important to the enterprise are placed on the block. Valuable assets and crucial income are hocked to the teeth. Shareholder voting rights are abrogated. Bizarre devices and instruments are invented and deployed in haste and often incur waste. Executives are voted exorbitant extended contracts. Fortunes are thrown away on greenmail, overpriced acquisitions and legal maneuvers. In sum, almost no executive temper tantrum today surprises the continuing observer of tender offers or proxy contests.

Were the stakes, consequences and notoriety of this now clearly tragic pattern not so very great, perhaps the failure of the law to redress it could be ignored, if not excused. But the stakes in takeover battles typically are so enormous, the consequences of incumbent defensive tactics both to

shareholders and to the public's respect for the law are frequently so devastating, and the pattern of escalating abuse has become so notorious, that the failure of our system of courts-enforced corporate law to come to grips with the problem can be neither ignored nor excused. Consideration must be given to changes in the system that will provide reasoned redress.

Generally there are two ways to change the established legal approach to an issue of importance: (1) public persuasion that affects the attitudes of the courts or (2) change that is imposed through legislation.

Public persuasion has been attempted. But to date it has been limited largely to scholarly articles written by academics and isolated newspaper editorials. The reaction of the corporate community has largely been a blend of private criticism and public silence. It may be that many in the corporate world who could contribute their persuasion are deterred by a fear that one day they may feel a need to resort to "defensive tactics" themselves. Others may be deterred by a recognition that they would face not merely the burden of attacking the courts but would have to take on the deans of the takeover bar many of whom have previously published self-justifying contrary views. Still others are just plain nervous about <u>any</u> federal revision of what traditionally has been state corporate law. They look upon any federal intrusion as the commencement of a slide down a slippery slope.

The moment is thus ripe for others, not so involved in the conduct at issue, to contribute their views and for the Congress to consider their message. That is why I came here today.

In my experience, there is today a widespread consensus among businessmen, lawyers, members of the press and others who follow the law and practices in this area that a pattern of arrogance and irresponsibility of incumbent executives and directors does exist. There is similarly a consensus that an effective manner to deal with defensive measures undertaken by incumbents faced with challenges to their control, as well as actions by corporate management seeking to take their companies private through leveraged buy-outs, would be for the judiciary to treat such actions as presumptively self-serving. Under those circumstances, the incumbents would not necessarily be deterred from what they believe to be right and prudent; they would merely have to offer a court proof that shareholders are being fairly treated by these activities. If they fail, the actions appear to be proper targets for comprehensive stand-still injunctions.

The basic questions raised by these notions are four, I think.

First: Is the business judgment rule a proper subject of federal legislation? As noted above, the most vocal critics of the proposal made here have made much of the shibboleth that the business judgment rule has been and should remain exclusively a state preserve. They talk about the rule as though it were the foundation of our entire economic and political system, and bemoan the slightest suggestion that the federal Congress has a role in that system or this aspect of it. While there are respectable concerns hidden in these views, I believe that its adherents overstate their case and are overwrought. Moreover, they offer no other solution to the problem that no state judiciary or legislature has seen fit to act appropriately or effectively in this area; indeed there does not even appear to be movement in that direction. There seems little reason to believe that were it to add to the Exchange Act an appropriate federal business judgment standard, Congress could fairly be said to have unwisely, or for the first time, invaded an area properly left to the states. The Congress has already so heavily federalized tender offer regulation, in large measure in the name of "fairness," that the Supreme Court has already held that Congress has preempted substantive state laws in the area. That in part reflects the continuing consensus that there is great need for uniformity in this area that episodic state law reform, even if it occurs, cannot achieve. This is, moreover, an aspect of corporate law that is peculiarly susceptible of federal resolution; put otherwise, whatever can be said for the tradition of state regulation of internal corporate affairs, its application to the externalities of the interstate stock exchanges is dubious at best both practically and theoretically. In sum, the interests of shareholders in the arena of battles for corporate control are already so heavily subject to federal regulation that there seems little justification to leave those shareholders at sea in hopes of rescue by non-existent forces operating under the vagaries of different states' rules.

Second: What should such a federal standard be? In my view, the most effective answer is also the simplest one. The Congress should mandate the application of the corrolary of the business judgment rule in contests for control. In plain English, the standard should be that which applies where self-interest is presumed: any action taken should be prudent for the issuer and fair to the shareholders and those with the power should have the burden of so proving. After all, what can be wrong with a rule that asks executives or directors simply to satisfy a court, when challenged, that they have acted

in the interests of the corporation rather than in their own self-interest and were fair to the shareholders as a whole?

Third: Is such a general principle approach preferable to a series of specific provisions such as have been submitted by the SEC or suggested by others? In my view, specific proposals are too specific to resolve the problems. However well-intentioned: they have the tone of regulation, rather than legislation; they create a risk of an unduly technical approach to an area best suited to the kind of general principles that have proved the most successful provisions of federal securities law thus far; and they threaten to turn the securities statutes into an internal revenue code in which semi-annual new reforms address new devices invented by the sophisticated.

Fourth: By whom, where and how should such a standard be enforced? In my view the answer should be that the SEC or any shareholder should be able to go to an appropriate federal court to enjoin any transactions believed to violate the standards. This would not create new litigation burdens for the federal courts. The federal courts already routinely hear these cases because there are existing federal issues always present. Shareholders are the parties with the economic interests. The Commission is charged with pursuing shareholder and the public interest. Accordingly, they both should have standing to sue. I would strongly suggest that any such suit should, however, be sharply limited in two related respects. First, the suit must be brought at the time; second, the suit should be limited to injunctive or other equitable relief rather than for damages. I do not believe it is practicably required or politically wise to expose directors to a risk of civil liability under the system I propose. A right to file a later damage suit might invite delay and strike suits after the eggs are broken and scrambled. Such suits would be the wrong remedy and commenced for the wrong reasons. What is needed is a way to test, and if necessary halt, questionable actions and transactions before they are implemented.

I have prepared and submitted to your Committee Staff, a draft of such an amendment to the Exchange Act, which is attached. I hope you consider it a worthy subject of further consideration. I am confident, in any event, that such consideration is warranted by recent history.

Thank you for your attention.

PROPOSED SECTION 14(h)

a. No issuer having a class of securities registered pursuant to Section 12 of this title, nor any affiliate of any such issuer, shall engage in any action in contemplation of effecting, or of defending against, a change in control of such issuer unless such action is prudent for the issuer and fair to the issuer's securityholders.

b. The Commission or any securityholder of such an issuer may bring a suit in the proper district court of the United States or of the District of Columbia to enjoin any such action and for such other equitable relief as may be appropriate on the ground that the action violates the standards in part (a) of this subsection.

c. In any such suit, the burden shall rest upon such issuer or affiliate to prove by a preponderance of the evidence that the transaction complained of is both prudent for the issuer and fair to the issuer's securityholders.

d. A court may award attorney's fees to a securityholder in such a case.

TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

October 2, 1984

Statement
by the
Honorable Thomas J. Healey
Assistant Secretary of the Treasury
for Domestic Finance
Submitted to the
Senate Committee on Banking,
Housing and Urban Affairs

It is a pleasure to have this opportunity to present the Administration's views on legislative proposals to regulate corporate takeovers. I understand that the focus of this hearing is on four specific proposals: (1) prohibiting so-called two-tier tender offers, (2) extending the minimum offering period from the current 20-business-day requirement to 45 days, (3) requiring corporate directors to own or agree to purchase at least 1,000 shares of stock of the corporations they serve, and (4) revising the business judgment rule to make managements of target firms accountable to justify that their actions are prudent for the firm and fair to its shareholders.

Due to the complexity of the issues presented and the fact that several of these proposals have only recently been introduced as legislation, the Administration has not yet developed specific positions on them. Thus, my comments today will be general. Furthermore, for reasons I shall explain, we have concluded that it would be premature for Congress to act on these proposals at this time.

BACKGROUND ON ACTIONS TAKEN BY THE ADMINISTRATION IN THIS AREA

CCEA Working Group. Last July, the President's Cabinet Council on Economic Affairs established a Working Group on Corporate Takeover Legislation to determine the extent of the problem of management abuse in tender offers and whether current Federal and state case law and regulations adequately protect against these potential abuses. Secretary Regan, who is Chairman pro tem of the CCEA, noted at that meeting that the Working Group will consult with SEC Chairman Shad in its review of tender offer practices. The Working Group has been meeting regularly since July, and I and other members of the Working Group have met with Chairman Shad on several occasions.

Letter to Chairman Dingell. On September 25, Secretary Regan sent a letter to Chairman Dingell of the House Committee on Energy and Commerce, with copies to Senators D'Amato and Riegle, outlining the Administration's strong opposition to enactment at this time of the Tender Offer Reform Act of 1984 (H.R. 5693), as amended and reported by the Energy and Commerce Committee. H.R. 5693 addresses several of the issues that are the subject of this hearing.

GENERAL CONSIDERATIONS ON REGULATION OF TAKEOVER BIDS AND DEFENSES

Concern about discouraging takeover bids. Corporate takeover attempts perform several beneficial functions in our economy. First, they provide a means -- sometimes the only feasible means -- of policing management conduct in widely-held public corporations. Second, they help identify undervalued assets and permit shareholders to realize the full value of their investments. Third, successful takeovers help realize efficiencies by reallocating capital and corporate assets into more highly valued uses; enabling merger partners to generate joint operating efficiencies; and providing companies with access to financial, management, and other resources not otherwise available.

Takeovers benefit shareholders of both bidder and target corporations. A recent review of economic studies of the market for corporate control concludes that "targets of successful tender offers and mergers earn significant positive returns". The same review finds that bidders in successful tender offers also earn positive returns, and further concludes that "the evidence suggests that takeovers create value". Indeed, there is no systematic evidence that takeover activity has done anything other than increase national wealth and improve efficient allocation of corporate resources. Thus, any legislation that would impede efficient operation of the market for corporate control runs the risk of causing significant harm. */

Earlier actions to regulate tender offers appear to have noticeably discouraged takeover attempts by increasing their costs. Congress' most significant intrusion into the takeover process occurred in 1968 with the passage of the Williams Act. In the year following adoption of the Williams Act, the number of tender offers declined by 40 percent from 115 to 70. The decline continued into 1970, when there were only 34 tender offers. This sharp downward trend in tender offers reversed itself in 1971, but the subsequent increase in tender offer

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*/ Jensen and Ruback, "The Market for Corporate Control: The Scientific Evidence", 11 Journal of Financial Economics 5 (1983).

activity was very gradual. Indeed, it was not until 1977 that the number of tender offers returned to the 1968 level. Tender offer activity dropped off sharply again in 1980, the year in which the SEC proposed another elaborate set of rules governing tender offers. At a minimum, these facts suggest that we should proceed cautiously in adopting new laws that could make takeover attempts even more expensive and burdensome. We are especially concerned about any laws that might operate primarily to reduce the number of tender offers and takeover attempts in the name of fairness to shareholders, although those same shareholders are the ones who benefit from such activities and who would lose if such activities were unduly restricted.

Concern about defensive tactics. Proposals to prohibit or regulate potentially abusive "defensive" techniques by target corporations raise a different set of concerns. These techniques all may have legitimate business purposes as well as the potential for abuse. It is often a difficult question of judgment whether a given technique, in a given set of circumstances, is in fact an abuse that protects incumbent management at the expense of shareholders. Sweeping legislative proscriptions on defensive tactics can therefore have unintended side effects. Congress should at a minimum pause for careful scrutiny of proposals that might harm the very shareholders that Congress seeks to protect.

Concern about Federal intrusion into state corporate governance law. Because the factual elements underlying a defensive action will often determine whether it is justifiable or abusive, this question is uniquely suited for case-by-case resolution in the courts rather than through the imposition of a Federal law which prohibits or inhibits defensive activity. The adjudicatory process, which generally applies state law standards to particular fact patterns, will over time produce a reasonable and well-understood set of principles that will define when and what kind of defensive action is appropriate. We should at least give the judicial process a chance to work.

Moreover, under our Federal system, we have traditionally relied on state law and market competition to discipline corporate managers who act against the interests of their shareholders. Diverse state corporation laws accommodate the wide variety of sizes, market strategies, product and service offerings, and other characteristics of our nation's business firms. They also permit a market test of alternative regulatory approaches to new and complex questions of corporate governance, such as those presented by recent takeover contests. In contrast, federalizing corporation law forecloses the market in state charters, eliminates the possibilities of different management approaches in different corporate circumstances, and prevents market competition from working to increase shareholder wealth.

Given the advantages of state law in this area, we believe a strong presumption exists against the establishment of Federal corporation law, even in part. In this regard, I would note that the SEC's blue-ribbon Advisory Committee on Tender Offers advised in its Report of Recommendations that Federal takeover regulations generally should not preempt or override state corporation law and that the "business judgment rule" should continue to govern most corporate activity. We believe the Federal government's appropriate role in overseeing corporate management decisions is limited to situations where an overwhelming broader national purpose is to be served, or where existing market disciplines are clearly failing to work effectively.

ADMINISTRATION'S OBJECTIONS TO ENACTMENT OF TAKEOVER REFORM LEGISLATION AT THIS TIME

In light of these general considerations, there are two reasons why we believe Congress should not enact corporate takeover legislation at this time.

Need for further study. First, the issues presented by these proposals are complex and their implications for the economy, corporate governance, and federalism are significant. Although we share the concerns of those who believe takeover abuses should be examined and, if necessary, controlled, we think it unwise for Congress to act precipitously without thoroughly considering the issues and understanding the consequences of any "reform" legislation. Is there sufficient evidence of the need for and effects of these proposals to justify changes of this magnitude? What are the costs to investors and the economy of legislation that may deter takeover bids? Would these proposals increase wasteful litigation? To what extent would they establish undesirable precedents for further Federal intrusion into corporate governance? If reforms are needed, is rulemaking preferable to legislation? Corporate takeover legislation has been the subject of only two days of hearings in the House, and until now, none in the Senate. Some abuses have occurred, but the need for reform is not acute. We believe Congress should take the time to give these important issues the full public debate they deserve.

Role of the marketplace. Secondly, it has not been established that the courts, investors, the marketplace, and the states are unwilling to regulate takeover abuses on their own. The Second Circuit's recent decisions in Joy v. North, rejecting the recommendation of a committee of independent directors to terminate a shareholder derivative action, and in Norlin Corp. v. Rooney, Pace, Inc., enjoining management's defensive tactics, suggest that the judicial system is becoming increasingly responsive to problems of corporate governance and, in particular, to abusive tactics

employed by target management. In addition, it seems inevitable that the marketplace will adjust to correct its problems. Shareholders and institutional investors will make managements more accountable. Individual corporations can adopt stricter charters and bylaws. If the courts and the marketplace fail, state legislatures have demonstrated their willingness to step in (although we acknowledge that there is some question as to their neutrality). In sum, a well-ordered marketplace is a powerful regulator. Given the substantial costs of Federal intrusion, we do not believe the evidence is sufficient at this time to warrant Congressional action.

CONCLUSION

In conclusion, Mr. Chairman, the Administration has serious concerns about rushing into any further legislation to regulate the corporate takeover process. While we acknowledge that abuses may have occurred and believe they warrant study and possible reform, these issues are too complex and their implications too important to be dealt with hastily. We urge the Congress to give these issues the thorough analysis and careful debate they deserve. We in the Administration are prepared to work with the Congress in any way we can toward a better understanding of these proposals and their implications.

Senator METZENBAUM. I do want to express my appreciation to Mr. Howell for being with us and sharing his views with us.

Since he agrees with me so much, I am particularly pleased.

Mr. HOWELL. I do have one additional thing, Senator D'Amato.

With regard to the right of all stockholders to obtain equal payment, it is recognized that both the 20- and 10-percent threshold concepts will result in precluding all partial tender offers as well as two-tier offers, the latter happened to be the abusive manifestation of partial offers.

However, viewing control of a corporation as an asset of the corporation, that each share of stock represents an equivalent portion of, no bidding practice should be permitted that fails to accord all shareholders of the corporation, particularly the small public shareholders, the right to receive their full participation when control of the corporation is acquired.

The same premise underlies the so-called control share acquisition concept in recent amendments by several States, including Ohio, Wisconsin, and Minnesota to their respective business corporation laws. Under those corporate law amendments, control of the corporation is considered one of the corporation's assets, and just as a sale or transfer of all or substantially all of the corporation's assets is subject to approval by a majority vote of shareholders under the State corporation law, the transfer of control of that corporation should similarly be the subject of shareholder self-determination by vote of those shareholders to approve the sale or acquisition of control.

And this deals with the English approach, I think, that was discussed earlier, and those three States have adopted that approach at this time.

Senator D'AMATO. Thank you very much. The committee stands in recess.

[Whereupon, at 4:40 p.m., the committee adjourned, subject to the call of the Chair.]

[Additional material supplied for the record follows:]

MERGERS AND ACQUISITIONS

PREFACE

Every profession develops specialized vocabularies; these serve to rid its internal discourse of cumbersome usages and to render complex ideas and practices in simple, concise terms, which, simplicitly notwithstanding, may be perfectly opaque to the laymen. The field of corporate mergers and acquisitions describes its own participants and transactions with a set of terms which, if not lurid, is extremely colorful. A striking number of these terms derive from predation, crime, and warfare; some observers have cited this lexical violence as evidence of a need for reform. This glossary presents short definitions of a selection of terms associated with mergers and acquisitions which have appeared in the extensive literature on the subject.

A GLOSSARY OF TERMS

A

ARBITRAGEUR.—a professional stock trader who deals in the stock of companies involved in takeover contests, or companies which seem likely to become involved in such contests in the near future.

B

BEAR HUG.—notification of a target company's management that a tender offer is imminent or under consideration. There are several variations: the "strong bear hug," in which the tender offer is made public, intensifying the pressure on the target company; the "teddy bear hug," an offer management believes it can fend off; and the "reverse bear hug," when the target company replies that it favors the merger, but at a much higher price than the one offered.

BIDDER.—the person, group or company making a tender offer for control of another company.

BLACK BOOK.—an outline of defensive tactics to be employed should a hostile takeover attempt be made.

BLOCK PURCHASE.—the acquisition of a large number of a company's shares. The purchaser can exert pressure on the company even without making a formal takeover bid—"greenmail" (see below) is a possible result.

BUSINESS JUDGMENT RULE.—a legal concept embodied in various State corporation laws which has provided management and boards of directors with virtual immunity from shareholder suits because their decisions can be challenged only on very limited grounds. Directors and managements of target companies often invoke the rule in defending themselves against shareholder suits which accuse them of acting in their own self-interest during takeover bids. Recent court decisions have lessened the immunity provided by the rule.

C

CREEPING TAKEOVER.—the gradual accumulation of a company's stock through purchases in the open market. Since Federal law requires no public disclosure of stock ownership or takeover intentions until one's holdings total 5 percent of a company's shares (see "section 13(d)"), a bidder may control a substantial portion of the target company's stock at the outset of a takeover contest.

CROWN JEWELS.—a firm's most valuable assets. To defend against a hostile takeover, the "crown jewels" may be sold or

optioned to a third party, thereby making the company less attractive to the bidder.

D

DEFENSIVE TACTICS.—actions taken by a target company to resist a takeover.

DROP DEAD FEE.—a fee paid by bidders to lenders when a proposed acquisition fails and the lines of credit established to finance the acquisition are not used. This arrangement allows bidders to commit themselves to large acquisitions, often worth billions of dollars, without actually having to borrow the money and risk overextending themselves in the financial markets.

E

F

FAIR PRICE PROVISIONS.—corporate charter or bylaw provisions requiring a bidder to pay the same price for all shares purchased. The intention is to prevent two-tier takeover bids (which see), in which one price is offered for some of the target's stock, and a lower price for the remainder.

FREEZE-OUT.—a type of merger in which a group or company which has obtained a controlling interest in another company forces the remaining shareholders to give up their interest in that company.

FRIENDLY TAKEOVER.—a merger supported by the management and board of directors of the target company.

FRONT-END LOADED TENDER OFFER.—see "Two-Tier Tender Offer."

G

GODFATHER OFFER.—a tender offer so generous that the target company management cannot reasonably refuse.

GOLDEN PARACHUTES.—employment contract provisions that guarantee very substantial severance payments to top management if they lose their jobs as the result of a takeover.

GREENMAIL.—a payment received (some would say extorted) from a company by a "raider" who has purchased a block of the company's stock and threatens to make a hostile tender offer. In order to negate the threat, the company buys the block of stock from the raider at a premium, that is, it pays more than the going market price. As a result, the value of other outstanding shares often decreases, thereby injuring the other shareholders.

GREY KNIGHT.—a company which enters into a takeover contest between two (or more) other companies, and whose intentions are ambiguous and not entirely welcome to either party. In contrast, a "white knight" (see below) comes to the "rescue" of the target firm.

H

HOSTILE TAKEOVER.—a merger resisted by the acquired firm.

I

INVESTMENT BANKER.—a financial intermediary, one of whose functions is to advise firms involved in or contemplating mergers and acquisitions. An investment banker's services may include selecting target firms, formulating strategy and tactics, and arranging financing.

J

JONESTOWN DEFENSE.—defensive tactics so extreme as to appear suicidal. The term first appeared during the Bendix/Martin Marietta/Allied/United Technologies merger battle.

K

L

LADY MACBETH STRATEGY.—a strategy wherein a third party appears to come to the aid of a target company in a hostile takeover attempt, in the manner of a "white knight" (see below), but then changes allegiance and joins with the acquiring firm.

LEVERAGED BUYOUT.—a transaction in which a group of investors acquires and "takes private" a publicly-owned company (or a division or subsidiary of a firm). The acquisition is usually initiated by an investment banker, often in partnership with members of the firm's management. The transaction also depends on borrowing most of the purchase price, using the firm's assets as collateral. Leveraged buyouts have been undertaken to prevent hostile takeovers.

LOCKUP.—an agreement between a target company and a proposed acquiror giving that acquiror an advantage over other potential bidders. Lockups may include: a stock purchase agreement for treasury or unissued shares, an option to buy treasury or unissued shares, an option to buy certain assets, a merger agreement, and other provisions.

M

MINIMUM OFFERING PERIOD.—the shortest time a tender offer may remain open—20 business days under current Federal law.

MITE CASE.—the Supreme Court decision of *Edgar* v. *MITE,* 102 S. Ct. 2629 (1982), which struck down the Illinois tender offer law as an unconstitutional restriction on interstate commerce.

N

O

P

PAC-MAN DEFENSE.—a tender offer made by the target of a hostile takeover bid for the stock of the original bidder.

POISON PILL.—an issue of securities, usually preferred stock, designed to discourage a hostile merger bid. Upon completion of a hostile takeover, the typical "poison pill" stock becomes convertible into cash or into the common stock of the acquiring company. The effect is to raise considerably the cost of the acquisition.

PORCUPINE PROVISIONS.—corporate charter or bylaw provisions meant to deter takeover attempts. For examples, see "fair price provisions," "golden parachutes," "poison pill," and "supermajority provisions."

Q

R

RAIDER.—a person, group, or company attempting to execute a hostile takeover. The term is frequently applied to those who specialize in hostile takeovers.

S

SANDBAG.—a delaying tactic, in which a target company agrees to negotiate a takeover bid, but seeks to draw out the negotiations as long as possible, hoping that it will be saved by a "white knight" or otherwise achieve a more favorable outcome.

SATURDAY NIGHT SPECIAL.—a tender offer made without the prior knowledge of the target company, and open for only the minimum offering period. The term dates from the 1960's when the minimum period was only 5 business days (versus 20 under current law), and when announcing tender offers during the weekend was a common practice.

SCORCHED EARTH DEFENSE.—the use of extreme defensive tactics which threaten to leave the target firm a financial cripple. Two examples: scheduling all debt to come due immediately upon the completion of a takeover; selling the "crown jewels" (see above). In one celebrated case, a group of Houghton Mifflin's authors threatened to find other publishers were that firm taken over.

SECTION 13(d).—the section of the Securities Exchange Act of 1934, as amended by the Williams Act of 1968, which requires that notice be filed with the Securities and Exchange Commission [SEC], with the target company, and with each exchange on which the target's securities are traded, within 10 business days after any person or group acquires "beneficial ownership of 5 percent or more of a class of registered equity securities." The disclosure form (SEC schedule 13D) must include, among other things, the source of funds for the acquired securities,

the purpose of the acquisition, and the buyer's future plans with respect to control of the target.

SECTION 13(d) WINDOW.—the 10 days between the acquisition of 5 percent or more of a firm's stock and the required public disclosure (see "Section 13(d)" above). During this period the acquiror may continue to buy the target firm's stock, and thus may own considerably more than 5 percent when the disclosure is made. (See also "Creeping Takeover," above).

SELF-TENDER.—a company's purchase of its own shares. This is frequently done to remove the shares from the reach of a hostile bidder, thereby lessening the prospect of the bidder's obtaining a majority of shares.

SHARK REPELLENT.—provisions in corporate by-laws designed to prevent hostile takeover bids (see also "Porcupine Provisions"). Also used for defensive tactics in general.

SHARK WATCHERS.—consultants who help corporations identify buyers of their stock, in order to provide early warning of takeover attempts.

SHOW STOPPER.—a lawsuit by the target company seeking a permanent injunction against the takeover bid.

SILVER WHEELCHAIRS.—see "Golden Parachutes."

STAGGERED DIRECTORSHIPS.—a defensive tactic—by staggering corporate directors' terms (having terms begin in different years, so that all directors are not elected at once), an acquiring company can be prevented from electing its own directors quickly.

STANDSTILL AGREEMENT.—an agreement whereby the bidder agrees to buy no more of the target's stock for a specified period of time.

SUPERMAJORITY PROVISIONS.—corporate bylaw provisions requiring that certain decisions, such as approval of a merger, pass by vote of a "supermajority" (70 to 80 percent) of shareholders.

T

TARGET.—the company that is the subject of a takeover bid.

TENDER OFFER.—a public offer to buy some or all of the stock of a corporation within a specified time period. Notice of the offer must be filed with the Securities and Exchange Commission on schedule 14D–1, disclosing, among other things, certain financial information about the bidder. The price offered is generally well above the current market price of the stock, to induce stockholders to tender their shares to the bidder.

TWO-TIER TENDER OFFER.—an offer to pay a certain amount per share, usually in cash, for a controlling interest in a corporation's stock, and then to acquire the remainder of the stock at a lower price, usually by means of an exchange of stock or a combination of cash and stock. Bidders using this technique hope that shareholders will "stampede" to tender their shares for the higher price offered on the "front end" of the deal, regardless of the wishes of the target company's management. This type of offer is also known as a "front-end-loaded tender offer."

U

V

W

WHITE KNIGHT.—a third party who agrees to acquire a target company, usually at that company's request, as an alternative to a hostile takeover by another bidder. The merger proposed by the "white knight" generally offers terms more favorable to the target company's management, and a higher price per share to stockholders.

X

Y

Z

98TH CONGRESS
2D SESSION

S. 2448

To amend the Securities Exchange Act of 1934 with respect to tender offers.

IN THE SENATE OF THE UNITED STATES

MARCH 20 (legislative day, MARCH 19), 1984

Mr. SPECTER introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the Securities Exchange Act of 1934 with respect to tender offers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following:

"(g)(1) After March 20, 1984, it shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to make a tender offer for, or a request or invitation for tenders of, any class of any equity security which is registered pursu-

ant to section 12, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G), or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 20 per centum of such class unless—

"(A) such person is the issuer of that security; or

"(B) the offer is a cash offer for all outstanding shares of the class.

"(2) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for purposes of this subsection.

"(3) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

"(4) The Commission shall, by rules and regulations or upon application of an interested person, exempt from the prohibition contained in paragraph (1) any class of securities of any issuer upon such terms and conditions and for such

period as it deems necessary or appropriate if it finds that such action is not inconsistent with the public interest or the protection of investors.".

○

98TH CONGRESS
2D SESSION

S. 2797

To require that directors of certain corporations hold securities of those corporations.

IN THE SENATE OF THE UNITED STATES

JUNE 27 (legislative day, JUNE 25), 1984

Mr. CHAFEE introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To require that directors of certain corporations hold securities of those corporations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) is amended by adding at the end thereof the following:

"(f) The Commission shall by regulation require that each such director of an issuer the equity securities of which are registered pursuant to section 12 either own at least one thousand shares of those equity securities, or agree to make periodic purchases of such shares using the total amount of

that director's fees for service as a director of such issuer until that director owns one thousand shares of equity securities of such issuer.".

○